

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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In re	: Chapter 11
	: :
REFCO INC., et al.,	: Case No. 05-60006 (RDD)
	: :
Debtors.	: Jointly Administered
	: :
	: Adv. Proc. No. 08-1129-rdd
-----X	
TONE N. GRANT,	: :
	: :
Plaintiff,	: Case No. 08-CV-4846
	: :
v.	: :
	: <i>Electronically Filed</i>
ILLINOIS NATIONAL INSURANCE COMPANY AND:	: :
NATIONAL UNION FIRE INSURANCE COMPANY	: :
OF PITTSBURGH PENNSYLVANIA,	: :
	: :
Defendants.	: :
-----X	

**DECLARATION OF WILLIAM A. SCHREINER, JR. IN OPPOSITION TO ILLINOIS
NATIONAL INSURANCE COMPANY'S MOTION TO WITHDRAW THE
REFERENCE FROM BANKRUPTCY COURT**

I, WILLIAM A. SCHREINER, JR., hereby declare:

1. I am an attorney admitted to practice before the United States District Court for the Southern District of New York. I am an attorney with Zuckerman Spaeder LLP in Washington, D.C. I respectfully submit this declaration in opposition to Defendant Illinois National Insurance Company's ("Illinois National") motion to withdraw the reference from Bankruptcy Court.

2. Attached as Exhibit A is a true and correct copy of the August 30, 2007 hearing transcript in *Axis Reinsurance Co. v. Bennett, et al.*, Adv. Proc. No. 07-01717 (RDD).

3. Attached as Exhibit B is a true and correct copy of the October 5, 2007 hearing transcript in *Axis Reinsurance Co. v. Bennett, et al.*, M-47 (JGK).

I declare under penalty of perjury that the statements made herein are true and correct.

Dated: June 9, 2008
Washington, D.C.

s/ William A. Schreiner, Jr.
William A. Schreiner, Jr.

EXHIBIT A

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

-----X
In Re: : 05-60006
REFCO, LLC, :
Debtor. :
-----X
AXIS REINSURANCE COMPANY, : 07-1712
Plaintiff, :
v. : One Bowling Green
BENNETT, et al., : New York, New York
Defendants. : August 30, 2007
-----X

TRANSCRIPT OF HEARING ON MOTIONS
BEFORE THE HONORABLE ROBERT D. DRAIN
UNITED STATES BANKRUPTCY JUDGE

APPEARANCES:

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(Appearances continue on next page.)

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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For Robert Trosten: RACHEL M. KORENBLAT, ESQ.
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(Appearances continue on next page.)

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

APPEARANCES CONTINUED:

For Sexton and Sherer: IVAN O. KLINE, ESQ.
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Court Transcriber: RUTH ANN HAGER
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Proceedings recorded by electronic sound recording,
transcript produced by transcription service

1 (Proceedings began at 10:20 a.m.)

2 THE COURT: Okay. Refco and the Axis Reinsurance
3 matters.

4 [Pause in the proceedings.]

5 MR. GOLDMAN: Good morning, Your Honor.

6 THE COURT: All right. There are a number of
7 matters on that generally come under the heading of the Axis
8 Reinsurance matters.

9 Have the parties discussed any particular order
10 that they want to proceed in?

11 MR. GOLDMAN: Good morning, Your Honor. Matthew
12 Goldman, Baker & Hostetler. I will be speaking on behalf of
13 what we have called the moving defendants, the parties seeking
14 a preliminary injunction for advancement of defense costs.

15 Yes, I have spoke with Joan Gilbride -- yeah. I
16 have spoken with Joan Gilbride. I believe at least insofar as
17 Axis and the other moving defendants are concerned, the
18 appropriate procedure would be that this court first determine
19 whether or not Arch should be permitted to intervene so that we
20 can determine whether or not they would be heard.

21 THE COURT: Right. I agree with you.

22 MR. GOLDMAN: Our suggestion --

23 THE COURT: I'd go with that first.

24 MR. GOLDMAN: Okay. Thank you, Your Honor. Then
25 our suggestion would be that we proceed with the motion to

1 advance defense costs, the motion to file by the motions to
2 dismiss or to stay. And insofar as the lift stay motions are
3 concerned, there is no objection to lifting the stay to the
4 extent that it is applicable to deal with the defense cost
5 issues. That's not in dispute at all. The only thing that is
6 potentially at issue in the lift stays in my supplement motion
7 asking for permission to also enter into settlements. We can
8 put that at the end because nothing about lift stay interferes
9 with this argument.

10 THE COURT: Okay. I appreciate that probably a
11 fair amount of thought went into that order of proceeding and
12 perhaps some tactical considerations too, but it strikes me
13 given the lack of any opposition, except the limited amount to
14 the part of the lift stay motion that ought to be be lifted for
15 all purposes, that I should hear the motion to dismiss first
16 and then deal with the issue of advancing defense costs,
17 particularly since the debtor doesn't seem to care about that
18 and it appears to be a dispute because they haven't taken any
19 position whatsoever on this and they've not opposed lifting the
20 stay.

21 MR. GOLDMAN: Your Honor, I didn't actually say
22 it's that material in that order.

23 THE COURT: Okay.

24 MR. GOLDMAN: So, yeah, if the Court wishes to do
25 dismissal first, that is fine with us, Your Honor.

1 THE COURT: Okay. That's fine.

2 MR. GOLDMAN: All right. So I think then that
3 means that we start with intervention?

4 THE COURT: So I need to hear from Arch, then,
5 first.

6 MR. GOLDMAN: Thank you, Your Honor.

7 MR. STANDISH: Good morning, Your Honor. Daniel
8 Standish of Wiley Rein on behalf of Arch Insurance Company.

9 Your Honor, we seek to intervene in this case for
10 the limited purpose of opposing the request for the advancement
11 of defense costs notwithstanding the existence of a coverage
12 defense that bars coverage for the claim in its entirety.

13 Arch is in the same tower of insurance as Axis.
14 Arch has the policy that is ten million dollars excess of 40
15 million dollars. At this point, the underlying limits have
16 been depleting rapidly. We understand that the burn rate at
17 this juncture is about two million dollars a month.

18 The demand that the officer defendants in this
19 case have made that Axis pay for their defense, fees and costs
20 on an as-incurred basis notwithstanding the existence of a
21 threshold defense. That is an issue that will affect Arch as
22 well in two different ways. One, it will affect the amount of
23 the policy limits that remain under the Arch layer, as well as
24 affect Arch's rights potentially as a precedential matter if and
25 when Arch's policy is reached, which at this point given the

1 burn rate at least the amounts incurred would certainly
2 implicate that level. So for that reason, Arch has a very
3 strong interest of that particular issue.

4 Arch also feel strongly about intervening in this
5 case because as Your Honor may recall in June of 2006 Your
6 Honor gave leave for Arch to file its declaratory judgment
7 action in New York Supreme Court in order to obtain an
8 adjudication of the coverage issues. Your Honor found that
9 Arch would be prejudiced if it were unable to do so.

10 Once we got before Justice Freedman, the officer
11 defendants who are now demanding that Axis advance defense fees
12 and costs argued to Justice Freedman that the Arch suit should
13 be dismissed without prejudice, because it was totally
14 speculative whether or not the erosion of the underlying layers
15 would ever occur and Arch's policy would be implicated. And
16 even if it did implicate Arch's layer, Arch could simply stand
17 in its denial and refuse to pay, less directly contrary to the
18 position that they've now taken before this court in demanding
19 advancement.

20 So for that reason, we feel that Arch's interest --

21 THE COURT: That wasn't the only reason they
22 opposed it, right?

23 MR. STANDISH: That was not the only reason.
24 That's correct, Your Honor. There was also an argument that it
25 would overlap with the underlying facts at issue in the

1 criminal prosecution going forward.

2 But Justice Freedman specifically did not reach
3 the issue of whether or not the insurers could be obligated to
4 include advance defense fees and costs notwithstanding the
5 existence of a threshold coverage defense.

6 Arch has moved promptly to intervene, Your Honor.
7 We've briefed this contemporaneously. We filed with our
8 intervention papers our opposition to request for advancement
9 and we don't feel that any of the defendants would be prejudiced
10 by the intervention. In fact, it would be far more efficient
11 to adjudicate this issue in the context of the same proceeding
12 than have it litigated again at some future juncture against
13 Arch in a separate pleading.

14 So for that reason, Your Honor, we submit that
15 permissive intervention is appropriate here and should be Arch
16 should be permitted to be in for this purpose.

17 THE COURT: But it's not necessarily the same
18 issue,, is it?

19 MR. STANDISH: With respect to the primary policy
20 language it is, Your Honor. Both the Axis policy and the Arch
21 policy incorporate by reference the language on which the
22 officers are relying for the advancement of defense fees and
23 costs. They're focusing in the primary policy in condition (d)
24 that says that the insurer shall advance the covered advanced
25 costs on an as-incurred basis. The dispute over whether or not

1 the advancement of covered advanced costs is required when the
2 policy excludes the defense costs is the same issue as to both
3 Axis and Arch.

4 The only distinction is in the policy provisions
5 on which Arch and Axis are relying for the denial of coverage.
6 Arch has its own prior knowledge exclusion in its policy and
7 there is no dispute in that case that that exclusion exists and
8 that it applies. There's a dispute in the Axis case over
9 whether or not the exclusion actually is in the policy. Axis
10 obviously takes the position that it is, but that dispute
11 doesn't exist as to Arch.

12 But with respect to the primary policy language,
13 the question of whether advancement of "covered defense costs"
14 means you have to advance uncovered defense costs is precisely
15 the same.

16 THE COURT: Okay.

17 MR. STANDISH: Thank you, Your Honor.

18 MR. KLINE: Good morning, Your Honor. Ivan Kline
19 from Friedman & Wittenstein in New York.

20 We represent in this action two of the officer
21 defendants, William Sexton and Sherer, arguing against the
22 intervention on behalf of them as well as defendants Klejna,
23 Murphy and Silverman, who are the five sort of moving insureds
24 on the advancement motion.

25 And even assuming there is some common question of

1 law, this is clearly a case where the Court should exercise its
2 discretion to deny the motion. This case is about coverage
3 under the Axis policy, not the Arch policy. We've asserted
4 counterclaim against Axis under the Axis policy. We have not
5 They are not mentioned or in any way involved the Arch policies
6 and we've made an advancement motion solely as against Axis
7 because its policy is now the one that's up, so to speak.

8 We have no claims against Arch. We haven't asked
9 for advancement against Arch. Arch wants to litigate not just
10 advancement in the abstract. It specifically says it wants to
11 intervene to litigate whether the Arch policy requires Arch to
12 advance defense costs, but nobody's made that request, so I
13 don't know against whom they're going to litigate that, because
14 we haven't made the motion. So procedurally there is a flaw in
15 what they seek to do, because nobody is seeking relief against
16 Arch, so they can't really be heard on an issue of when their
17 policy requires advancement of defense costs. In fact, they
18 rely very clearly on a specific provision of their policy,
19 which we have not briefed, we have not addressed because we
20 have no claims against them.

21 There's also a procedural flaw which their own
22 proposed opposition brief set out and that they didn't address
23 in their reply when we pointed it out. They state in their
24 proposed brief and opposing advancement that in order for there
25 to be an advancement motion, there has to be an underlying

1 claim to support the request for relief, which advancement
2 would go with. For example, the five moving insureds have
3 counterclaims against Axis and it's those counterclaims with
4 declaratory injunctive relief that support our request for
5 advancement.

6 Arch points that out because it says others aren't
7 really empowered to advancement anyway, but then it still seeks
8 to adjudicate advanced under its policy just by itself without
9 being hooked on in any way to any claim by or against it. And
10 it's created its own procedure conundrum. It recognized it
11 can't come in here to seek to intervene and litigate coverage
12 under the policy, because that would be barred by Justice
13 Freedman's order. So instead they're seeking just to litigate
14 this advancement issue, but you can't really litigate that in
15 the abstract by itself without the coverage under the policy
16 also being in dispute. They themselves state that in their
17 proposed opposition brief.

18 In terms of the other procedure flaw would be if
19 Your Honor granted that intervention, you know, then what? We
20 haven't made a motion against Arch, so how Your Honor adjudicate
21 whether advancement is required under the Arch policy when we
22 haven't briefed it, and we have no intention at this point of
23 briefing it, and may never have to brief it.

24 And in terms of judicial efficiency, some court is
25 going to have the coverage dispute against Arch unless it, you

1 know, goes away due to one cause or another. It's not going to
2 be this court, because by their own statement they can't come in
3 here now to seek to adjudicate coverage. So to have this court
4 somehow rule in the abstract on advancement under the Arch
5 policy simply makes no sense when some other court will have
6 the coverage issue. And in both cases they're going to be
7 raising the prior knowledge exclusion in their policy as the
8 key provision to look at.

9 Now, clearly for purposes of efficiency if we ever
10 want to seek advancement under the Arch policy, we'll have to do
11 something. We'll have to do it in some court where coverage is
12 also at that issue. And in terms of what Arch's counsel said
13 we're already in consistent positions, advancement was not an
14 issue before this.

15 THE COURT: Oh, you don't have to get into that
16 one.

17 MR. KLINE: All right. I think that covers the
18 points I want to make, unless Your Honor has some further
19 questions.

20 THE COURT: Okay. Why isn't counsel right that, as
21 you said, the common issue here is coverage under the primary
22 policy and coverage was raised in state court so why isn't this
23 really an end run around the state court decision?

24 MR. KLINE: There are different coverage issues.
25 This coverage issue is not reached by Justice Freedman. At

1 pages 3 to 4 of the rule --

2 THE COURT: But she said it was premature and this
3 shouldn't be happening now.

4 MR. KLINE: She found that the litigation of the
5 application of the Arch exclusion was premature. What Justice
6 Freedman did not reach was the question that is being presented
7 by the motion for preliminary injunction to be argued this
8 morning of whether or not under language of the primary policy
9 and applicable law an insurance company that has denied,
10 regardless of the basis, can't -- has to be obligated in advance
11 defense fees and costs notwithstanding the existence of that
12 coverage defense when the demand is made and has to instead
13 litigate issues of coverage all the way to a conclusion and
14 then try to recoup those amounts.

15 That limited question is the question on which
16 Arch seeks to intervene here, and that's the question that's
17 presented by the motion for preliminary judgment. Regardless
18 of what the specific coverage defense is, the common issue is
19 whether or not given the language of the primary policy that
20 only requires the advancement of covered defense costs, the
21 Court should turn a blind eye to that language and enforce the
22 advancement of those defense fees and costs anyway until there's
23 some final adjudication in the coverage litigation.

24 THE COURT: But I mean, you're using the same term,
25 covered, coverage. It's the same term and it's the same

1 analysis, isn't it, that she went through?

2 MR. KLINE: No, Your Honor. The analysis --

3 THE COURT: I mean, I understand that she had an
4 alternative basis for her ruling, so one of her bases -- we
5 went through this point on coverage.

6 MR. KLINE: Your Honor, Justice Freedman did not
7 look at the advancement language in the policy. In the Supreme
8 Court, the director defendants actually asked Justice Freedman
9 to enter an order for the advancement of defense fees and costs
10 until final adjudication of the coverage issue. And in her
11 opinion she expressly did not reach that issue, so the specific
12 issue on which we seek to intervene in this matter were reached
13 by Justice Freedman.

14 THE COURT: They're not asking for it here.

15 MR. KLINE: They are, Your Honor, in their
16 preliminary injunction papers.

17 THE COURT: Not from Arch.

18 MR. KLINE: They are asking it from Axis and it
19 will be the same issue under the primary policy language
20 because both Arch and Axis incorporate by reference conditions
21 D-2 and D-3, which are at issue in this case.

22 Because of that overlap Arch has interest in the
23 income. I have no doubt that depending on the outcome here one
24 side or the other will be able to tout that if and when the
25 Arch layer is ever reached. And given the burn rate on defense

1 expenses and the demands for settlement that are now being
2 bandied about, I have no doubt that the existence of coverage
3 under the Arch policy will be squarely at issue in the very
4 near future based on the communications that we're receiving.
5 And at that point, we're going to have to deal with this issue.

6 It's much more efficient to deal with the issue in one
7 proceeding when that same language is at issue on that issue.

8 THE COURT: Even though you have different
9 language in your own policy from --

10 MR. KLINE: The exclusionary language differs.
11 That's correct, Your Honor.

12 THE COURT: Okay.

13 MR. STANDISH: Your Honor, I just want to
14 reiterate. Their motion very clearly says they seem to
15 intervene to litigate the issue whether the Arch policy
16 requires Arch to advance defense costs. They're not coming in
17 seeking to just talk about whether in general we can get
18 advancement or whether under the Axis policy we're entitled to
19 advancement and question whether they even have standing to do
20 that.

21 In that sense, they're like any insurer that may be
22 out there that may have language similar to the primary policy
23 in any case. You wouldn't allow that insurer to come and
24 intervene in this case. And here, they've already been told by
25 Justice Freedman they really can't do what they're now seeking

1 to do. And if you look at their proposed brief, it's full of
2 references that their policy, their prior knowledge to
3 exclusion. They're seeking to argue the applicability of that
4 exclusion albeit to try to avoid advancement as against them,
5 which has not been sought.

6 THE COURT: Okay. Arch Insurance Company has
7 moved for permission to intervene under Rule 24(b) incorporated
8 by Bankruptcy Rule 7024(b) in this declaratory judgment
9 litigation between a lower tier insurer, Axis Reinsurance
10 Company and various defendants, former directors and officers
11 of Refco, Inc. The movant acknowledges that there's not a
12 complete overlap of the issues in the Axis Reinsurance
13 litigation and the litigation that it would want to pursue if
14 it were permitted to intervene, which would be to seek a
15 declaratory judgment that it, that is Arch, would not be
16 obligated under the Arch policy for advance defense costs to
17 the directors and officers beneficiaries of Refco's insurance
18 with it. That is because exclusions relied upon by Arch in its
19 policy differ from exclusions relied upon by Axis.

20 The common issue that Arch relies upon for
21 purposes of Rule 24(b) is language in the first tier policy
22 pertaining to covered claims as they relate to defense costs,
23 among others -- or losses as defined in the policy, which is a
24 link in the logical chain that if broken might prevent Arch
25 from pursuing certain of its arguments, if not all of them,

1 that it does not have to advance coverage. No beneficiary of
2 the policy is actually apparently at this time sought to compel
3 Arch to advance coverage. I would also note that the debtor in
4 this case has appeared to be completely neutral on the issue
5 and is not a party to this litigation and has taken no position
6 whatsoever.

7 It appears to me that to the extent that it is a
8 common issue of law in fact to the extent there's any factual
9 issue in interpreting the relevant insurance policies, it would
10 not be a proper exercise of my discretion to permit Arch to
11 intervene. As is clear from the briefing on the motions before
12 the Court today in connection with the Axis Reinsurance matter,
13 first, the actual language of the policy is important.
14 Second, issue of rightness or whether the Axis litigation is
15 premature are important and are to some extent back driven, in
16 particular driven by the claimed exigencies faced by the policy
17 beneficiaries, the officers and officers who have felt the
18 pinch of not getting the coverage at that tier.

19 To my mind, it would therefore be inefficient to
20 include Arch in this litigation at this time and it would
21 instead be efficient to pursue the issues that are truly before
22 the Court in this litigation, that is, the issues involving
23 Axis and the directors and officers' claims against Axis and not
24 use this litigation as a funnel to invite any prospective
25 insurer to join some sort of massive proceeding.

1 That's compounded by two other considerations.
2 First, I note that Arch pursued in New York State court
3 declaratory judgment litigation regarding the terms of its own
4 policy and coverage under that policy and the state court ruled
5 that that litigation was premature. It seems to me in large
6 extent -- this is an end run around that ruling -- that, i.e.,
7 Arch's request intervene here would be an end run around that
8 ruling. And at a minimum that if I permitted Arch to
9 intervene, we would be frequently interrupted in litigation by
10 considerations of whether what Arch is in particularly seeking
11 at that particular moment if I permitted it to intervene would
12 be an end run around that order or whether the order would be
13 binding on it.

14 Finally, as I noted at the pretrial conference on
15 this matter, I continue to have some concern given (a) that
16 Refco's plan is confirmed and effective and substantially
17 consummated and (b) that Refco, the debtor, has no participation
18 in this litigation at all as to the extent of my jurisdiction
19 over it. And in light of all the other factors that I've
20 already mentioned arguing that I should not exercise my
21 discretion to further expand this adversary proceeding to
22 involve other insurers it seems to me that Arch's issues, if
23 they're to be brought at all, should be brought in another court
24 when they become ripe.

25 So I'm not sure which of the -- these [inaudible]

1 here took the lead on this matter, but certainly you could
2 submit an order consistent with my ruling denying the motion.

3 I would ask you just to send a -- well, you can
4 work it out among yourselves. I'd just ask you to send a copy
5 to Arch's counsel. You don't have to settle it on him, but just
6 send him a copy at the same time you're sending it to chambers
7 or as a courtesy you may want to send it to him a day before so
8 he can determine that it's consistent with my ruling.

9 MR. KLINE: Okay. No problem.

10 THE COURT: Okay. Okay. All right. So that
11 leads to the motion to dismiss.

12 [Pause in the proceedings.]

13 MR. WALSH: Michael Walsh from Weil, Gotshal &
14 Manges on behalf of all of what we call the director
15 defendants. That's Brightman, Ganter, Harkins, Jeakel Lee,
16 O'Kelly and Schoen. It seems like Your Honor is very familiar
17 with the background here, but I can just run through the
18 structure if that would be helpful.

19 THE COURT: Okay.

20 MR. WALSH: Refco arranged the known insurance in
21 the amount of 70 million dollars. That consists of a primary
22 policy and five Axis policies. Axis provides a third tier in
23 that tower, that is, the second Axis policy and all of the Axis
24 policies follow the form of the primary policy, except to the
25 extent that they're explicitly different. This means that the

1 Axis insurers are actually bound by the terms of the primary
2 policy. The language that's key to today's dispute both in
3 connection with the motion to dismiss and the motions to compel
4 advancement is the language in the primary policy that requires
5 the advancement of defense costs as they're incurred and unless
6 it is finally determined that such costs are not covered.

7 We understand that this issue is now coming to a
8 head with respect to Axis because that the coverage or the
9 amount under the primary policy and the amount under the first
10 Axis policy are almost used up, at least that's our
11 understanding. So I know this states the obvious, but the only
12 reason we're here, Your Honor, is because Axis wants you to tell
13 them that they don't have to advance defense costs. And the
14 rest of those, even though we've chosen different ways to
15 opposed that, are here because we want to make sure that they
16 do pay. Now, we recognize that Axis had two valid choices
17 here. The first is to advance defense costs with the
18 reservation of rights, which is what we think is what
19 the policy envisions and the second is seek a declaratory
20 judgment that the costs are not covered by the policy.

21 Now, U.S. Specialty, the insurer under the primary
22 policy in Lexington, the insurer on the first Axis chose --
23 ultimately chose option one and they just -- they reserved
24 their rights, and Axis has chosen option two.

25 We recognize that seeking a declaratory judgment

1 of coverage can be perfectly appropriate. And, for example, if
2 there were no underlying litigation claims or if the litigation
3 claims were -- did not overlap, we're not disputing the
4 procedure. What we are disputing is when there's a substantial
5 overlap of the underlying facts, we believe the law is clear.
6 A declaratory judgment may not precede and has to defer to the
7 underlying litigation for a determination of those facts. And
8 we believe this is pretty much the universal rule. We don't
9 think the rule is different in Illinois than in New York. I
10 think the rule is exactly the same.

11 And, Your Honor, there are at least two key
12 reasons for that rule. The first is that there is a
13 significant risk that a determination -- early determination in
14 the coverage action would be prejudicial in the underlying
15 actions either through collateral estoppel, the law of the
16 case, or even -- or for other issues.

17 The second reason is since if you're litigating the
18 same issues at the very least you're duplicating effort. You're
19 running up even more defense costs, more expenses on the very
20 same things and that seems to be counter to good sense and
21 issues of judicial economy.

22 So we filed our motion to dismiss and we believe
23 that what we're saying in the motion to dismiss is that because
24 the courts are clear, the courts are clear that when there is a
25 substantial overlap the coverage action must defer, that under

1 Rule 12(b)(6) Axis is not in a position to be able to prove
2 their case and therefore dismissal without prejudice is
3 appropriate.

4 Now, let me get to the core of the issue, which is
5 substantial overlap. Here in Refco on the one hand we've got
6 the criminal and fraud actions. And the factual issues
7 underpinning those actions all relate to whether Bennett and
8 others manipulated Refco's books and records. All of the
9 alleged actions that relate to the manipulation appear in the
10 indictment, and in the various securities complaints, and
11 interestingly enough, they're all explicitly referred to in
12 Axis's complaint.

13 On the other hand, we have the coverage action.
14 Now, Axis's characterization is that the factual issue is
15 whether Bennett failed to disclose potential claims based on
16 his alleged manipulation of the books and records. But saying
17 it that way doesn't change the fact that the facts are really
18 the same. Without the alleged manipulation, there's nothing
19 really to disclose.

20 Axis points to Illinois law, in particular the
21 Guydant [Ph.] case as determinative. First of all, we strongly
22 disagree that Illinois law applies and I can come back to this,
23 Your Honor, but the absence of a choice of law in the contract
24 means that under New York's choice of law rules look at various
25 factors, the most important of which is the location of the

1 insured risk. And given that Refco's principal place of
2 business was in New York, that's where the executive officers
3 did their business and all the allegations related to coverage
4 issue were about actions taken by certain executive officers.
5 It's hard to argue that New York was not the location of the
6 insured risk. But even if the New York law applied, we think
7 that the answer on substantial overlap would be the same and
8 we're going to focus on Guydant.

9 Now, before I do, though, I do want to make a
10 point that there are Illinois decisions on the issue of whether
11 advancement is appropriate during the pendency of a coverage
12 action where New York law and Illinois law appear to differ
13 markedly, and that is why we believe New York law is the law
14 that should apply here. But for the substantial overlap, we
15 think the test is pretty much the same.

16 So in Guydant, what was going on? In the
17 underlying actions, you have essentially a bunch of personal
18 injury claims that were couched in language of fraud. And I'm
19 assuming that they were done that ways, because today's medical
20 dominate to society if you're going to have something implanted
21 in your body, undoubtedly you're going to be signing a waiver,
22 an assumption of the risk. And the only way around that is to
23 demonstrate that you are not told all of the appropriate facts.

24 So the underlying factual issue is the misrepresentation about
25 the safety of the medical device and the risk of the medical

1 device.

2 In the coverage action, however --

3 THE COURT: Well, can I -- I'm sorry. Go ahead.
4 Go ahead.

5 MR. WALSH: in the coverage action, however, it's
6 not that the device was actually defective or unsafe, but that
7 complaints had been received by the company, that the company
8 knew about and didn't disclose, so that's why the Guydant case
9 made a distinction and we can -- they were saying that we can
10 make a determination. The trial court can make a determination
11 that as a factual matter, yes, they received complaints or,
12 yes, they didn't receive complaints, and it's not really
13 dependent upon whether the device was defective or not.

14 So the distinction with our case is in Refco you
15 can't make that distinction. Without one, you can't have the
16 other. At the end of the day, Axis can't get up and explain to
17 you what was it that Bennett should have disclosed if in fact
18 he did not manipulate the books or he did not commit fraud?
19 What was there to disclose?

20 So as you noted earlier, Your Honor, although not
21 involving Axis, this is not the first time this issue came up.

22 Justice Freedman addressed this very issue in connection with
23 Arch's request for a determination on coverage.

24 The way I view it, Your Honor, this is a classic
25 problem of putting the cart before the horse. You've got all

1 these -- this huge multi-district securities actions that's all
2 coming together and you've got the criminal complainants, and
3 then you've got this coverage action. And what I foresee is if
4 this coverage action really went forward on the issues and was
5 going to determine the issues of what Bennett did, what he
6 thought, et cetera, every plaintiff in the securities actions
7 would have to come into this court, and all the discovery about
8 all the facts would be taking place in this court. And it just
9 seems completely backwards in my mind that the coverage dispute
10 becomes the litigation for all these issues rather than the
11 underlying actions. I just don't think that can be right.

12 From a policy perspective, I have to ask myself
13 what -- you know, what's the purpose of the DNO policy and it's
14 to protect officers and directors against claims for
15 misconduct. And in my view, it would completely defeat that
16 policy. If the end result was that the insurer could do an end
17 run and avoid the defense costs and get a ruling that could be
18 used against the insured in the underlying actions, that's not
19 what people will opine all this insurance for. That doesn't
20 provide any protection at all, so the answer here is, you know,
21 clearly Axis has an issue here. They have to -- in our view,
22 they have to advance defense costs but they have the right to
23 get those costs back once there is a decision on coverage if,
24 in fact, it does go against the insureds.

25 On the part of the defendants, though, if they

1 don't get defense costs, they -- any insurance may very well be
2 a lower. We think the courts have assessed those competing
3 risks and come down on this issue in favor of the insured.

4 So in this situation, we believe it's perfectly
5 appropriate that the insurer has to wait for the results of the
6 underlying action, and that's what you have today, and that's
7 our reason, Your Honor, for asking the Court to dismiss the
8 case.

9 THE COURT: Okay. So you take the view that I
10 don't need to look at the policy language itself and interpret
11 on the merits whether -- on a 12(b)(6) basis whether Axis is
12 right or not. You just say it's premature?

13 MR. WALSH: Your Honor, it is our expectation that
14 if this action was dismissed and especially if it was dismissed
15 with the determination that New York law applies that Axis
16 would go ahead and advance. You know, they're a highly, highly
17 reputable company. If, however, they stand up today and say
18 you know, no way. We're advancing. Then we'll have to go the
19 next step, but what we're asking for today is a dismissal.

20 THE COURT: Okay. Thank you.

21 MS. GILBRIDE: Good morning, Your Honor. Joan
22 Gilbride for Axis Reinsurance Company, Kaufman, Borgeest &
23 Ryan.

24 I'm a little confused after hearing oral argument
25 from the director defendants on their motion for dismissal.

1 Essentially, what they've sought from this court is a complete
2 dismissal of this action, but at the same time they appear to
3 be suggesting that they should get some sort of affirmative
4 relief in the form of advancement of defense costs.

5 THE COURT: Not Mr. Walsh's clients.

6 MS. GILBRIDE: It's just -- it's -- what they're
7 essentially seeking, though, Your Honor, is an inconsistent
8 result.

9 THE COURT: But his clients haven't sought that.
10 They haven't sought any sort of affirmative relief. They just
11 sought dismissal.

12 MS. GILBRIDE: I just think it's important to note
13 that Axis's position has been Axis's position for over a year is
14 that there is no coverage for this matter under its policy.
15 They took this position over a year ago. Axis is not going to
16 change that position if this action gets dismissed. In fact,
17 what the director defendants have said in their papers and I
18 think have suggested to Your Honor is if this action is
19 dismissed, they would have no alternative but to turn around
20 and seek relief under the policy in another forum. And I think
21 that just demonstrates the inconsistency, which a dismissal of
22 this action would result in particularly in light of the fact
23 that there are other defendants, other insureds who are seeking
24 affirmative relief from Your Honor. In any event --

25 THE COURT: But why would that be the case if the

1 other forum were, for example, the Court handling the
2 underlying litigation? Then all the discovery could be the
3 same, all the trials could be the same. There wouldn't be two
4 courts with potential conflicting rulings or conflicting
5 schedules and particularly for the criminal defendants risks
6 about the Fifth Amendment.

7 MS. GILBRIDE: Well, Your Honor, that leads into
8 really what is the heart of this dismissal motion, which is
9 whether or not there are overlapping facts. We believe the
10 issue is not whether there's substantial overlap of the facts,
11 but whether the ultimate issues in the two dispute are the same
12 and I think that that's clearly the test under Illinois law,
13 which we submit applies to this dispute.

14 And the ultimate issues in the two cases are
15 ultimate facts, the ultimate issues that the Court must
16 determine are entirely different. The facts in the coverage
17 dispute concern -- we have a warranty letter that we received
18 from the insured. The question is was the warranty letter
19 signed. It was signed on behalf of all insureds. Was there
20 knowledge by Mr. Bennett or any other insured at the time that
21 warranty letter was signed, which might have led anyone to
22 assume that there could potentially be a claim.

23 Those issues are very different than the issues
24 that are in dispute in the securities fraud action, Your Honor.
25 You know, Axis does not have to establish that there was a

1 fraud here. They simply have to establish that there was
2 knowledge that there was this warranty letter that was signed.

3 There's a knowledge exclusion in the policy, which we
4 understand there's issues about that. Those issues are not in
5 dispute in the underlying securities litigation.

6 THE COURT: I'm sorry. Knowledge of what?

7 MS. GILBRIDE: Knowledge of whether or not there
8 were facts at the time that the policies that was entered into
9 that could potentially lead to a claim. That doesn't --

10 THE COURT: And isn't the -- all of the litigation
11 brought against the Ds and Os a claim or potentially a claim?

12 MS. GILBRIDE: It is, Your Honor. But it's not the
13 only claim that either Mr. Bennett or any other insured could
14 have had knowledge of at the time they signed that warranty
15 letter.

16 THE COURT: But it's the only claim that they're
17 claiming on the policy on.

18 MS. GILBRIDE: Well, I think it's -- you know, it's
19 a big picture claim, but there were other issues and it's
20 important to note that the warranty and the prior knowledge
21 exclusion don't require knowledge of a claim. They require
22 knowledge of a fact, a circumstances, a situation. It's
23 extremely broad, Your Honor.

24 So, for example, if there was an auditor's letter
25 that was written in 2003 that Mr. Bennett was aware of and he

1 was aware that there were issues raised in that auditor's letter
2 that could potentially result in a claim and which ultimately
3 did result in partially at least in some of the claims.

4 THE COURT: But aren't I right in assuming that by
5 now any litigant or more practically speaking any plaintiff's
6 lawyer would have jumped in and brought the claims against
7 these directors and officers and that therefore it's in the
8 litigation that's pending?

9 MS. GILBRIDE: I think that that's a correct
10 assumption, Your Honor.

11 THE COURT: So aren't I also correct that in that
12 litigation that's pending won't those people also want to obtain
13 discovery of auditor's letters that he might be aware of or that
14 any of the other directors might have been aware of or any of
15 the other facts that would relate to a claim, because that's
16 what they're trying to establish, a claim. Isn't it a complete
17 overlap of the policy?

18 MS. GILBRIDE: Your Honor, I think there's no
19 question that there are overlapping facts in dispute. There's
20 no question. But the ultimate facts and the ultimate issues
21 that need to be decided in the coverage dispute are much
22 narrower and more focused than the very broad issues that are
23 in dispute in the underlying securities fraud litigation. And
24 in fact, the coverage --

25 THE COURT: I thought you were making the argument

1 the other way around. I thought you were saying that, in fact,
2 the securities litigation is more focused because we could
3 be -- anything that might have gone through Bennett's mind could
4 exclude Axis from having to pay. I mean, that's a pretty -- I
5 mean, I guess that's something that you can assert given the way
6 that provision is phrased, might give rise to a claim, although
7 it kind of makes you wonder whether the insurance is completely
8 illusory. But you're saying that the -- maybe I misunderstood
9 you then. You're saying that the actual litigation, the
10 criminal litigation and then the securities actions and the
11 like would be more narrowly focused or wider focused?

12 MS. GILBRIDE: I think, you know, narrow or wider
13 in different areas I think, Your Honor, but the important issue
14 is that the ultimate facts to be determined in the two actions
15 are different and I think that's the test. No one in the
16 securities litigation is going to care one way or the other
17 factually whether or not Mr. Bennett signed a warranty for an
18 insurance application. That's simply not going to be an issue.

19 THE COURT: Well, if you're talking that there's a
20 fact as to whether the thing was actually executed?

21 MS. GILBRIDE: I don't really think that's in
22 dispute, but that is, in fact, what we have to establish in
23 order to prevail in our coverage.

24 THE COURT: But don't you think that the district
25 judge presiding over that litigation could decide that pretty

1 quickly?

2 MS. GILBRIDE: Your Honor, I don't think that's an
3 issue that's before the district judge. It's not an issue --

4 THE COURT: No, but if, in fact, I determine that
5 this litigation for me is premature particularly in light of my
6 very tenuous jurisdiction given that Refco's plans confirm
7 effective and the provisions of the confirmation order, which
8 clearly contemplate that this type of litigation could be
9 elsewhere, why shouldn't the -- why shouldn't the easy lifting
10 issue not control this thing and the hard lifting issue should,
11 i.e., all the discovery as to whether there really was
12 something related to a fraud, which is already before the
13 district courts which probably have those issues? What --
14 they're going to be doing the heavy lifting. Why have two
15 courts do the heavy lifting, which requires all the parties to
16 duplicate the heavy lifting in two different forums because of
17 what appears to be perhaps even a hypothetical issue as to
18 whether Bennett signed the memorandum, which is easy lifting?
19 Why not have the district judge do that, too?

20 MS. GILBRIDE: Your Honor, I -- you know, another
21 procedural conundrum that we're faced here is that dismissal is
22 not sought by all of the insureds, so -- and there are --

23 THE COURT: No, but I can --

24 MS. GILBRIDE: -- counterclaims --

25 THE COURT: In controlling my docket, I can

1 certainly do that, particularly when I have real doubts about
2 jurisdiction. That's what Judge Gonzalez did in Worldcom.

3 MS. GILBRIDE: Your Honor, I -- you know,
4 obviously that is within your discretion and your control. Our
5 position simply is that this is a dispute that does not involve
6 all of the over-arching issue that are involved in the
7 securities litigation.

8 THE COURT: But other than whether Mr. Bennett
9 signed the memorandum or the warranty, what other issues are
10 different?

11 MS. GILBRIDE: Just the very fact of the
12 insurance, Your Honor, it's not an issue in the underlying
13 securities litigation.

14 THE COURT: What do you mean by that?

15 MS. GILBRIDE: Whether or not there's coverage,
16 whether or not their defense costs are covered.

17 The issue -- the other motion that we're here on
18 today, the advancement of defense costs, whether or not those
19 defense costs will be covered, that's not an issue that is in
20 dispute or before --

21 THE COURT: It could certainly --

22 MS. GILBRIDE: -- Judge Lynch.

23 THE COURT: It can certainly come before Judge
24 Lynch, though, couldn't it? I mean, it came before Judge Cote
25 after Judge Gonzalez said he didn't have jurisdiction in

1 Worldcom.

2 And as a practical matter, as we all know,
3 litigations are also a forum for settlement and as we all know
4 insurance in these settings is a major aspect, sometimes the
5 only aspect, but always a major aspect of the currency for
6 settlement. So I would think whether it's Judge Lynch or a
7 special master he's going to appoint or a mediator, that's --
8 you know, it's going to be front and center there as a practical
9 matter.

10 And I'm sure that if there's a mediation or
11 settlement discussion in the securities litigation -- obviously
12 this doesn't apply to criminal litigation but in the securities
13 litigation -- that one of the issues that the insurers will
14 raise, even if it's not teed up formally in front of Judge
15 Lynch, but in the negotiations is, well, we don't have to pay
16 for this. It's not covered, so plaintiff's lawyers, you should
17 look somewhere else. Lower your demand, because you're settling
18 two things. You're not only settling the fraud case, you're
19 settling whether this exclusion applies.

20 MS. GILBRIDE: Well, Your Honor, one of the
21 practical issues that Axis faced in deciding which forum to
22 bring this litigation in is that there is no diversity
23 jurisdiction, so we could not be before Judge Lynch or any
24 other district judge, so there was no way for us as a practical
25 matter to get before Judge Lynch. That was a consideration,

1 but we felt it was appropriate to bring the action in this
2 court, Your Honor, because of the fact that obviously that
3 we're -- you know, the bankrupt -- the debtor is here before
4 Your Honor and, you know, based upon prior rulings of Your
5 Honor with respect to the insurance policy, we believe that
6 this was an appropriate forum to be in.

7 THE COURT: Well, I haven't made any rulings as --
8 you mean, the lift stay issue?

9 MS. GILBRIDE: Yes, Your Honor.

10 THE COURT: Okay. But the plan confirmation order
11 says that "Notwithstanding anything in the plan or confirmation
12 order, to the contrary nothing in the plan or confirmation
13 order including, but not limited to the injunction provisions
14 shall be construed to prevent present or further directors and
15 officers of the debtors from seeking and obtaining coverage and
16 payments from insurance policies of Refco, Inc. or from
17 insurance policies of any other Refco entity by litigation
18 against relevant insurance companies nor to prevent insurance
19 companies from making such payments."

20 MS. GILBRIDE: Your Honor, we don't read that as
21 allowing us to affirmatively bring a declaratory judgment
22 action. And perhaps it was an incorrect reading of that
23 provision, but our understanding was that was limited to the
24 individual directors --

25 THE COURT: Okay. But it's a --

1 MS. GILBRIDE: -- and officers.

2 THE COURT: -- big difference between seeking
3 relief of the stay and starting, you know, a whole
4 declaratory -- anyway, I'm not faulting you on that obviously.
5 We're here. But I'm still having a hard time seeing why there
6 isn't overlap.

7 MS. GILBRIDE: Your Honor, I could not stand in
8 front of you and honestly say there is no overlap. There is
9 absolutely overlap. It's just a question of whether the overlap
10 is of some facts and there are some many facts that are -- do
11 overlap, but there's not overlap of the ultimate facts and the
12 ultimate issues that are going to be determined in each
13 litigation.

14 This is a dispute that's about coverage. There are
15 some issues that are similar that we've raised in terms of
16 Mr. Bennett's knowledge and other insured's knowledge, but the
17 issue before Your Honor is an issue of policy interpretation,
18 contract interpretation. The issue in the securities
19 litigation is an issue of whether or not there was fraud on the
20 shareholders and that's certainly not an issue that's in our
21 case whether or not there was a fraud.

22 THE COURT: But --

23 MS. GILBRIDE: So we don't believe that the
24 ultimate issue is --

25 THE COURT: But isn't Mr. Walsh's argument right

1 that the prior knowledge of a claim that's the ultimate basis
2 for the disclaimer coverage here and defense costs, the
3 obligation to advance defense costs, isn't that different than
4 the types of fraud at issue in the Guydant [Ph.] case?

5 MS. GILBRIDE: Your Honor, you know, I think that
6 the Guydant case is vary on point with the issues that are at
7 issue here. In Guydant, the question was whether or not there
8 was a nondisclosure of an underlying situation to the insurer.
9 It's the very same issue --

10 THE COURT: No, but of what?

11 MS. GILBRIDE: Of whether or not there was
12 litigation or prior claims, so it's almost -- it's very on
13 point, Your Honor.

14 THE COURT: But your provision doesn't say that.
15 You're not looking to deny coverage here because Bennett didn't
16 disclose to you that there was an investigation in place and
17 that there was a claim that had been asserted. It's that the
18 condition that might give rise to something like that was not
19 revealed to your client.

20 MS. GILBRIDE: That's correct, Your Honor, but I
21 think that --

22 THE COURT: And so --

23 MS. GILBRIDE: -- the issu --

24 THE COURT: -- in the defraud actions that were
25 pending in Guydant were not about what was already known to --

1 what specific claims that had been filed were already known to
2 the insured. They were about whether the insured failed to
3 disclose information to the investing public about what it had
4 been doing with its medical business. If that litigation had
5 been about the failure to disclose -- if the 10K in that
6 litigation had failed to disclose specific litigation claims or
7 medical claims against it, there would have been an overlap,
8 right?

9 MS. GILBRIDE: Well --

10 THE COURT: But that's not what it was about.

11 MS. GILBRIDE: Well, respectfully, Your Honor, I
12 think that issue in Guydant was whether or not -- was about
13 whether or not certain claims were disclosed to the insurer.
14 The situation that we have here --

15 THE COURT: Not the securities litigation.

16 MS. GILBRIDE: Not the securities litigation.

17 THE COURT: Right.

18 MS. GILBRIDE: But the claims involving the
19 products. But I -- you know, respectfully I just I think that
20 it's -- the question is whether or not there was nondisclosure
21 and whether it was about the securities litigation or not
22 securities litigation. It was about facts that were known at
23 the time. Here --

24 THE COURT: No, but it's important to know what --
25 to distinguish what the particular facts are. I mean, the

1 policy if -- if you're the -- if you're the Court presiding over
2 the insurance dispute, you have to ask yourself, well, what
3 will I learn from the securities law action that will either be
4 dispositive or provide real guidance as to my dispute. And in
5 the Guydant case if you're the judge presiding over that
6 insurance dispute, I'm not sure that those facts are relevant
7 because it's a different type of fraud. There are two different
8 types of fraud that are being litigated. The fact -- the
9 underlying nondisclosure is different.

10 MS. GILBRIDE: I think that's -- it's correct that
11 the underlying nondisclosure was different. There's no
12 question, but I think it was the fact of the nondisclosure that
13 was the issue and it was the same issue in both cases but the
14 ultimate issue in both cases was different, so I believe that
15 the Guydant -- how the Guydant court determined that issue is
16 very instructive in this situation for Your Honor.

17 THE COURT: But isn't this doctrine of prematurity
18 or ripeness, isn't it really ultimately a doctrine based upon
19 considerations of fairness and efficiency as opposed to, you
20 know, distinctions or technical distinctions between the
21 ultimate issue in each matter? I mean, obviously the ultimate
22 issue is going to be different in each matter because it's a
23 given that the people suing for securities fraud are not
24 specifically suing to enforce the terms of insurance policy, so
25 it's -- you know, there's always going to be a difference on the

1 ultimate issue in some respects.

2 MS. GILBRIDE: Your Honor, I do believe that it is
3 an issue of fairness and judicial economy and I believe -- you
4 know, we have a ripe dispute. There's no question, but there's
5 a ripe dispute right now between Axis and its insureds. Axis
6 is getting requests for advancement and requests to -- all
7 sorts of requests for depletion of its policy limits. So
8 there's no question but that we have a ripe dispute and that we
9 believe that this is the appropriate forum to be in to resolve
10 that dispute.

11 We do not believe -- you know, all of the issues
12 that are in dispute in the securities litigation are not in
13 dispute in this case. This is -- and I apologize if there was
14 any misimpression given, but I believe this is a much more
15 narrow --

16 THE COURT: But isn't there always a dispute? I
17 mean, it's not really a ripeness issue, is it? If it were a
18 ripeness issue, then this doctrine of overlap wouldn't apply
19 because the Courts don't say that the securities -- that the
20 Court handling the securities law case has to decide the
21 insurance dispute. It just says that we're not going to -- we,
22 the insurance court, are not going to decide it. Now, am I
23 right on that?

24 MS. GILBRIDE: I think you are right on that, Your
25 Honor. I think -- and what I was trying to articulate not very

1 clearly apparently was that you were asking whether this was
2 about judicial economy and fairness to the parties and I think
3 that that is what this is about and that is what drives that
4 doctrine, and this -- no one can suggest that this dispute is
5 premature. This is not a premature dispute. There is
6 certainly a dispute. There is a dispute that can be litigated.

7 We believe it will be a much more narrow litigation than the
8 securities litigation that's in the District Court before Judge
9 Lynch. And we believe that it serves the interests of judicial
10 economy and fairness to all parties. And, you know, in
11 particular Axis who's being asked to make payments as policy
12 limits without being allowed to get a ruling from a court that
13 there's no coverage under the policy.

14 THE COURT: But isn't -- doesn't in effect what
15 these overlap cases hold is that the insurer, you know, has to
16 take a back seat on that? I mean, isn't that a consequence to
17 these decisions?

18 MS. GILBRIDE: I think that is. When -- and I
19 think when that happens the reason it happens is because the
20 issues that are in the coverage litigation are going to be
21 decided in the underlying litigation. So, for example, if
22 there's an underlying dispute that involves issues of negligence
23 and issues of intentional conduct and the insurer is saying,
24 well, we don't cover intentional conduct, in those situations
25 courts -- and that's the vast majority of the cases that deal

1 with this issue -- the courts say, well, it's a waste of our
2 time to decide whether there was negligence or intentional
3 conduct, because that will be decided in the underlying case.

4 THE COURT: Right.

5 MS. GILBRIDE: Here, that's not the situation. The
6 coverage issue that we have, whether or not the prior knowledge
7 exclusion applies and whether or not the warranty letter
8 applies, are not going to be decided in the securities
9 litigation.

10 So for those reasons, Your Honor, I don't
11 believe --

12 THE COURT: I thought you were going somewhere.

13 MS. GILBRIDE: -- the dismissal --

14 THE COURT: I guess I thought you were going
15 somewhere else with that, which is that were going to have to
16 take our chances on advancing or not advancing defense costs
17 pending a decision and that -- and I thought you were going to
18 say that's not fair and the cases don't deal with that issue,
19 but don't they?

20 MS. GILBRIDE: Your Honor, I don't believe they do
21 because as far as I know, there's not one case cited before Your
22 Honor which has the precise language that is at issue in this
23 dispute where Axis is only required to advance covered defense
24 costs.

25 THE COURT: But that --

1 MS. GILBRIDE: Not --

2 THE COURT: I'm sorry, go ahead.

3 MS. GILBRIDE: No, I was just going to -- none of
4 the cases that have been put before Your Honor deal with that
5 precise issue and that certainly has not been an issue in any
6 dismissal rulings that have been put before Your Honor.

7 THE COURT: But isn't it the case that the insurers
8 are decline -- in the cases where there's a dismissal without
9 prejudice based on this doctrine of substantial overlap isn't it
10 the case that the insurers have denied coverage or sought to
11 rescind, which would include rescission of their obligation to
12 pay defense costs?

13 MS. GILBRIDE: I think in the vast majority of the
14 cases that have so held, Your Honor, the situation was that you
15 have an insurer, a duty to defend insurer who was required to
16 advance defense costs, and was taking a position that because
17 there was negligence and intentional conduct they didn't have to
18 defend -- they didn't have to pay defense or provide a defense
19 for any of those claims.

20 THE COURT: Right.

21 MS. GILBRIDE: So in that situation where the
22 Court said the coverage dispute is premature, the insurer did
23 have a duty to defend the entire action, but our situation --

24 THE COURT: So it was ripe because they had to pay
25 the money even though they said they didn't have to.

1 MS. GILBRIDE: It was ripe, but based on the
2 policy language that was in dispute in those cases, I think
3 here the distinguishing fact is that Axis's policy only requires
4 it to advance covered defense costs.

5 THE COURT: But doesn't everyone have a
6 distinguishing fact, that's why they brought their lawsuit to
7 rescind, you know. I mean --

8 [Laughter.]

9 THE COURT: I understand your --

10 MS. GILBRIDE: Yeah.

11 THE COURT: -- point --

12 MS. GILBRIDE: Your Honor --

13 THE COURT: -- of specific provision, but --

14 MS. GILBRIDE: Yeah. I'm not sure how to answer
15 that. I think that was in jest, but obviously there's always
16 different disputed facts.

17 I don't think I have anything more to add on this
18 issue unless Your Honor has any further questions for me.

19 THE COURT: Okay.

20 MS. GILBRIDE: But, you know, in summation I would
21 say that, you know, we don't believe dismissal is the
22 appropriate remedy. If Your Honor is concerned about the
23 overlaps and facts, there are other remedies that could be
24 considered, particularly stay or stay as part of the action is
25 that was what Your Honor is --

1 THE COURT: Well, the directors and officers
2 represented by Mr. Walsh are looking for dismissal without
3 prejudice. They recognize that this issue is going to come up
4 if it's not settled somewhere. So I mean, isn't that tantamount
5 to a stay?

6 MS. GILBRIDE: Your Honor, I think they do --

7 THE COURT: And --

8 MS. GILBRIDE: -- in the alternative ask for a
9 stay.

10 THE COURT: Well, someone -- I don't think so. I
11 think that's the criminal defendants --

12 MS. GILBRIDE: Okay. Okay.

13 THE COURT: -- that are asking for a stay.

14 MS. GILBRIDE: That's my confusion, then.

15 THE COURT: I under -- this is kind of off the --
16 you can stay up there if you want.

17 MS. GILBRIDE: Sure.

18 THE COURT: But it's addressed to everybody and
19 really it's off the point, but I -- does anyone know how the
20 insurance litigation got before Judge Cote? I would assume
21 that there would have been lack of diversity there as well.
22 Maybe no one argued -- maybe no one raised the issue.

23 MALE SPEAKER: Your Honor, I believe there's a
24 motion of jurisdiction --

25 THE COURT: There was.

1 MALE SPEAKER: -- actions were filed by the
2 carriers in the same courthouse and --

3 THE COURT: Okay.

4 MALE SPEAKER: -- it was before Judge Cote.

5 THE COURT: All right.

6 MALE SPEAKER: Little different situation.

7 THE COURT: All right.

8 MR. FERRILLO: Your Honor, Paul Ferrillo from
9 Weil, Gotshal. I was with Mr. Borgeest in that case, too.
10 There's another piece to that was I think Judge Cote took part
11 of this on the related jurisdiction and that the --

12 THE COURT: Under bankruptcy.

13 MR. FERRILLO: It was -- yes, on -- for the 1334.
14 She took a piece of it on the 1334.

15 THE COURT: Well, that's conceivable here, I would
16 think. I mean, I -- as I said, I've got -- I raised this
17 jurisdictional issue at the pretrial conference and I was
18 convinced enough then, since the policy is property of the
19 estate, and there's some possibility that it will flow over in
20 some way to the estate that there could be jurisdiction here,
21 but as you all know my jurisdiction becomes constricted after a
22 plan goes effective. And while it may still exist, it may
23 much -- it made more -- much more readily be employed by
24 District Court that in an action that for a lot of reasons it
25 would be efficient for the District Court to employ it that

1 way, so I wouldn't necessarily rule out that you couldn't raise
2 it in that forum but that's neither here nor there, I guess.

3 MS. GILBRIDE: Thank you, Your Honor.

4 THE COURT: Okay.

5 MR. WALSH: Except a couple points, Your Honor.
6 First of all, I don't have any problem with your jurisdiction in
7 this case, but I understand the posture of the case is in --

8 THE COURT: Well, let me be clear. I've not
9 determined that I lack jurisdiction. It's just that I need to
10 be careful about it and not over extend it and let other issues
11 sort of creep in through the limited jurisdiction that I have.

12 MR. WALSH: I appreciate that, Your Honor.

13 I just wanted to respond to a couple of things
14 that were said. And perhaps I heard this wrong, but I thought
15 what was said was that what -- in Guydant the standard was not
16 a substantial overlap and I think that's incorrect. Guydant
17 says "As a general matter a declaratory judgment action to
18 determine an insurer's duty to indemnify its insured should not
19 be decided prior to the adjudication of the underlying action
20 where the issues to be decided in both actions are
21 substantially similar." So that's the standard under Guydant.

22 And we have essentially the same effect in New
23 York in the Xerox case where the Court said that "The general
24 rule is that a declaratory judgment as to a carrier's obligation
25 to indemnify may be granted in advance of trial of the

1 underlying tort action only if it can be concluded as a matter
2 of law, but there is no possible factual or legal basis on
3 which the insurer may eventually be held liable under this
4 policy." So I think that that sets the standard. It doesn't
5 have to be, you know, precisely the same.

6 And, in fact, if there wasn't a substantial overlap
7 I have to ask the question why is it that Axis spent five pages
8 and 20 paragraphs reciting the allegations in the indictment in
9 the Grant memo? I think the only answer is because those facts
10 are key to the issue of -- that there had to be disclosure of
11 claims.

12 The only other thing I want to point out is the
13 contract and maybe this goes to the issue of fairness, but the
14 contract requires advancement unless there's a final
15 determination, and I think that's the quandary that acts as --
16 finds itself in and that's what they should do. They should
17 live up to their contract. Thank you, Your Honor.

18 MS. GILBRIDE: Your Honor, just briefly because I
19 can't let it go unchallenged, but the policy does not require
20 advancement. It requires advancement of covered defense costs,
21 but --

22 THE COURT: I know. Mr. Walsh sort of put back
23 his statement that he wasn't seeking a termination as to the
24 policy.

25 MS. GILBRIDE: And it's a very key word in the

1 policy and it's, you know --

2 THE COURT: I understand there's a heated dispute
3 over that issue.

4 [Pause in the proceedings.]

5 THE COURT: Does anyone else want to be heard on
6 this particular motion, that is, the motion to dismiss?

7 MR. GOLDMAN: Your Honor, Matthew Goldman. I'm
8 assuming that the Court will proceed after this two-hour
9 motion. It's --

10 THE COURT: Yes.

11 MR. GOLDMAN: -- our view obviously that -- I've
12 listened to a lot of what I was going to say already being
13 discussed with the Court, so --

14 THE COURT: Okay.

15 MR. GOLDMAN: -- I presume I'll get an opportunity
16 to be heard on that issue, Your Honor.

17 THE COURT: Okay.

18 MR. GOLDMAN: Thank you, Your Honor.

19 THE COURT: Absolutely. Also, the motion for
20 relief from the stay.

21 [Pause in the proceedings.]

22 THE COURT: All right. I have before me a motion
23 by certain defendants in this adversary proceeding, namely
24 Messrs. Brightman, Gantscher, Harkins, Jaekel Lee, O'Kelly and
25 Schoen, who define themselves as the director defendants.

1 To dismiss the adversary proceeding under Federal
2 Rule 12(b)(6) incorporated by Bankruptcy Rule 7012, the
3 standard for determining a motion to dismiss is well
4 recognized, that is, the Court must accept all factual
5 allegations in the complaint as true, although the plaintiff
6 must plead more than labels and conclusions and a formulaic
7 recitation of the elements of the cause of action will not do.

8
9 See Bell Atlantic Corporation v. Toombley, 127
10 Supreme Court 1995 at 1965 2007, but with the caveat announced
11 in the Bell Atlantic case or reaffirmed in the Bell Atlantic
12 case, the Court should determine whether based on the facts set
13 forth in the complaint as well as other sources that the courts
14 are permitted to examine under Rule 12(b)(6) and including in
15 particular documents incorporated in the complaint by reference
16 in matters which the Court may take judicial notice of.

17 The plaintiff should be entitled to ultimately
18 submit evidence and establish the facts alleged or whether it
19 should be precluded as a matter of law from going forward.
20 Here these particular debtor defendants -- director defendants
21 are seeking dismissal without prejudice on a relatively narrow
22 basis, that is, unlike certain of the other beneficiaries of
23 the Axis Reinsurance policy, they're not asking the Court to
24 determine that Axis is required to advance defense costs by the
25 terms of the policy.

1 Instead, although they're obviously not agreeing
2 with Axis's position that it's not required to advance those
3 costs, these director defendants contend that because of the
4 substantial overlap of the issues raised by Axis's declaratory
5 judgment complaint with the issues pending in respect of the
6 underlying claims which the beneficiaries contend trigger their
7 rights under the policy in the District Court and in pending
8 securities litigation as well as in any other litigation, but
9 primarily that litigation, that the Court should not proceed
10 here with a determination of essentially those same issues or
11 at least issues that substantially overlap with the issues
12 pending in the District Court.

13 This basis for dismissal without prejudice is well
14 recognized in the case law. See National Union Fire Insurance
15 Company v. Xerox Corporation, 792 NYS 2d. 772 (New York Supreme
16 Court 2004) affirmed 807 NYS 2d. 344 (New York Appellate
17 Division 2006) as well as In Re: Adelphia Communications
18 Corporation, 302 B.R. 439 (B.R. SDNY 2003).

19 It is not only, however, a principle in New York,
20 but also recognized, it appears to me, based on reading the
21 parties' pleadings generally throughout the country and Axis, I
22 believe, acknowledges the fundamental proposition that if there
23 is a substantial overlap of the issues in coverage litigation
24 with other pending litigation related to the claims to be
25 covered that the coverage litigation should take the back seat.

1 Axis contends, however, that as a factual matter
2 there is not an overlap that would require a dismissal here.
3 It relies heavily upon a decision out of Illinois, Alliance
4 Insurance Company v. Guided Corporation, 839 NE 2d. 113
5 (Illinois Appellate Court 2005) in making its argument.

6 I should note, however, that the Guydant case
7 enunciates the general proposition that a declaratory judgment
8 action to determine an insurer's duty to indemnify its insured
9 should not be decided prior to the adjudication of the
10 underlying action where the issues to be decided in both
11 actions are substantially similar. That's at page 120.

12 So it appears to me, at least on the general
13 proposition that there's no real conflict between the law of New
14 York and the law of Illinois here on this key proposition of
15 law. And where there is no such conflict, the Court need not
16 continue with a choice of law analysis.

17 However, I will do so because there is some
18 distinction, although I don't think a major one, between how the
19 Guydant Corp. Case -- I'm sorry, the Guydant Corp. court
20 analyzed the overlap issue from how other courts have done so
21 in New York.

22 In that regard, although this is more relevant to
23 Axis's interpretation of its rights in respect of the policy
24 generally, which are not being litigated here by these
25 particular director defendants, Axis contends that this dispute

1 in this declaratory judgment action is governed by Illinois
2 law, whereas the director defendants contend to the contrary
3 that it should be governed by New York law.

4 I've not seen a provision in the policy itself
5 setting forth the choice of law, and no one has cited that to
6 me. Instead, they have properly set forth the choice of law
7 rule in the absence of such a provision, which is that New York
8 choice of law rules should apply here given that this action is
9 being determined by a court in New York and that the center of
10 gravity analysis which, as far as I'm concerned, is
11 substantially the same as if not entirely the same as
12 substantial contacts analysis would apply as to disputes in
13 respect of insurance coverage.

14 The parties also generally agree on the factors to
15 be considered in connection with such an analysis. In looking
16 at those factors here and taking note particularly of Refco,
17 Inc.'s headquarters and the place where its executives took the
18 actions or allegedly took the actions at issue here, as well as
19 the residence of substantially all the defendants, the
20 headquarters of the insurer, but primarily where the underlying
21 activity occurred, it appears to me that New York law should
22 apply.

23 And therefore, to the extent that there is any
24 substantive disparance [ph.] on the so-called substantial
25 overlap doctrine, I would follow the dictates of new York law

1 and as it applied by the New York cases.

2 In considering those cases, it appears to me that
3 the rationale for applying the doctrine fits these particular
4 circumstances. That rationale is twofold. First and most
5 important, it reflects a policy not to prejudice the parties'
6 rights in the underlying pending action with the risk of -- in
7 particular in criminal actions, but also in civil actions
8 having to make disclosures and litigate in two forums with
9 potentially and consistent results. And as importantly in this
10 context and particular given the insurance context and the
11 issue of advancing defense costs greatly increased cost, that
12 rationale dovetails into the second rationale, which is one
13 based on judicial efficiency.

14 As discussed at oral argument, it appears to me
15 that this is not -- this doctrine is not really one that should
16 best be defined as ripeness, per se, because there is obviously
17 a ripe issue that is being deferred in the cases that apply to
18 the doctrine, that is, the insurer contends one way or another
19 that it is not responsible for paying under its policy. The
20 courts say nevertheless that that issue should not be decided
21 first where there's substantial overlap with the underlying
22 litigation. Rather, the insurer should either perform its
23 obligations or at its own risk not perform them and contend
24 later that it never had an obligation to perform them as the
25 underlying litigation proceeds.

1 I note in this respect that as set forth at length
2 by Judge Cote in In Re: Worldcom Inc. Securities litigation,
3 354 F. Supp. 2d. (455 SDNY 2005), there are strong policies
4 under New York law with regard to interpreting insurance
5 policies in favor of the insured particularly in construing the
6 meaning of exclusions incorporated into a policy of insurance
7 or provisions seeking to narrow the insurer's liability. And
8 further, that the distinct and separate duty of an insurer to
9 pay defense costs, that is, distinct and separate from a duty
10 to indemnify is broader than the duty to indemnify and not to
11 be taken lightly as a policy matter. That may help to explain
12 in addition to the notions of fairness and efficiency why this
13 doctrine goes beyond the doctrine of ripeness.

14 Now, turning to Axis's argument that there is not a
15 substantial overlap between the litigation pending before me
16 and the multi-district securities litigation and other
17 litigation that it is asserted by the defendants here give rise
18 to an obligation to advance defense costs and if liability is
19 ultimately found or there's a settlement, an obligation to pay
20 indemnification it appears clear to me that there is indeed a
21 substantial overlap between that litigation and the declaratory
22 judgment litigation before me.

23 Axis as set forth in its complaint is relying
24 primarily, although not exclusively, upon a warranty letter so
25 called by Axis, received at the time that -- or in connection

1 with in the words of the complaint the underwriting of the Axis
2 policy. That warranty letter provides as follows: "(a) No
3 person or entity proposed for this insurance is cognizant of
4 any facts, circumstance, situation, act, error or omission
5 which he, she, it has reason to suppose might afford grounds
6 for any claim AS SUCH TERM IS DEFINED WITHIN THE POLICY such as
7 would fall within the scope of the proposed insurance" and then
8 one exception is listed to that.

9 And then "(b) No person or entity proposed for this
10 insurance is cognizant of any inquiry investigation or
11 communication which he, she, it has reason to suppose might
12 give rise to a claim as such term is defined within the policy
13 such as would fall within the scope of the proposed insurance."

14 Other bases for the refutation of coverage are set
15 forth in paragraphs 49 and 50 of the complaint, as well as
16 paragraphs 52 and 53, but it seems to me that leaving aside
17 issues of what's in the policy itself as opposed to what's
18 extrinsic to it and may give rise to some other claim, the
19 focus of the discussion regarding overlap has been over the
20 language quoted and more particularly over the language quoted
21 in paragraph (a) of the so-called warranty.

22 It appears to me that one considers the fact that
23 the plaintiffs in the securities fraud litigation are suing the
24 defendants in respect of claims or what would be claims if they
25 prevailed. They will be seeking in discovery and seeking to

1 prove the defendants' cognizance of circumstances, situations,
2 acts, errors or omissions that would give rise to such a claim,
3 i.e., their knowledge of, and/or participation in frauds and
4 other bases for the claims in the securities action. That will
5 be the subject of discovery, which as is evident by the
6 enormous costs that have already been incurred. And I note
7 here that we're now here in the third layer or the second layer
8 of Axis coverage is enormous, multi-million dollars.

9 The plaintiffs will be, if they've not already been
10 seeking to obtain from the defendants those are also the issues
11 I believe that if the litigation has decided on its merits will
12 be determined by the District Court.

13 As I said in oral argument, I believe those are
14 also issues that would come up in any settlement discussions
15 with the insurer and the insurer's inevitable statement to the
16 plaintiffs that even if the defendants are liable the
17 plaintiffs shouldn't look to the insurers because they
18 disclaimed coverage under this warranty and other provisions
19 set forth in the complaint.

20 So I believe that there is indeed a substantial
21 overlap between the issues raised in the complaint and the
22 pending litigation. That's highlighted by the fact that the
23 complaint relies almost exclusively, if not exclusively, on
24 recitations from either -- well, recitations from documents
25 filed in the securities action or related criminal proceedings

1 to establish the breach of the warranty and the insurer's rights
2 under the other exclusion is referred to in the complaint.

3 I believe these facts distinguish this matter from
4 the matter before the Court in the Guydant case where it
5 appears clear to me that the Court considering insurance
6 coverage issues in the Guydant case had to consider different
7 underlying factual issues as to the nature of the -- as to a
8 different type of fraud that would have given rise to arguably
9 a denial of coverage.

10 As I noted at oral argument, the issues that do
11 not overlap here and inevitably there will be some because we're
12 dealing with here an insurance policy as opposed to the facts
13 that might give rise to a right under the policy or under
14 related documents to disclaim coverage should not guide my
15 decision. Those differences do not call into question issues
16 of efficiency or fairness. As I said before, the heavy lifting
17 in this dispute is over the underlying factual point as to
18 whether there was knowledge of conditions giving rise to a
19 claim. That's heavy lifting first instance by the parties in
20 their discovery and in the second instance by the parties and
21 the Court in determining the merits of that contention and
22 that's already going to be taking place in the District Court.
23 It seems to me that, therefore, this litigation should be
24 deferred under the substantial overlap cases to await
25 determination by the District Court or those underlying issues.

1 It also seems to me that there is a basis as
2 discussed in oral argument if the District Court agrees -- for
3 the District Court to have jurisdiction over these issues if
4 they are to be teed up there, as was done in the Worldcom
5 Securities case, which involved a similar situation where a
6 plan had been confirmed and gone effective and the Bankruptcy
7 Court had some concern about how involved it should be in
8 issues that should be primarily between third parties to the
9 bankruptcy case.

10 So on that basis, I will grant the director
11 defendants motion to dismiss without prejudice, although I
12 would strongly encourage the parties if they were ultimately to
13 pursue this litigation to pursue it in a different forum
14 because of the jurisdictional concerns that I've raised.

15 Mr. Walsh, you can submit an order to that effect
16 after circulating it to counsel for Axis.

17 MR. WALSH: I will do that, Your Honor.

18 THE COURT: And I suppose to your allies in the
19 defendant group.

20 MR. WALSH: Thank you, Your Honor.

21 THE COURT: Okay.

22 MS. GILBRIDE: Your Honor, if I may just to
23 clarify, you've now dismissed the entire litigation?

24 THE COURT: Well, that's my inclination. I'll hear
25 oral argument, but that's my inclination. I'll hear oral

1 argument on this motion, but it seems to me it all should go.

2 MS. GILBRIDE: Your Honor, it seems to me if
3 another court, another forum is going to hear this issue, there
4 really is no --

5 THE COURT: Well, you know what? As far as the
6 other defendants are concerned, that's my preliminary ruling. I
7 don't want to -- I said specifically to Mr. Goldman and his
8 colleagues that I would hear them out on this other point, but
9 that's my strong inclination.

10 In other words, he has an uphill fight.

11 MR. GOLDMAN: And I heard that, Your Honor. Okay.
12 So I guess it's one of the disadvantages of going last. You
13 get so many other things resolved for you and said. Let me
14 make this easier for all -- everyone.

15 First of all, there's no reason for me to discuss
16 facts. I don't think there's a single fact that has been raised
17 in here in our papers that has not been discussed by the Court
18 so far this morning, the provisions in question, and the
19 primary insurance policy, the follow-on provisions, and et
20 cetera.

21 I would add that I felt and feel that the Court
22 has raised the jurisdiction issue, of course, at the pretrial
23 hearing as well as today. I will indicate for the benefit of
24 the Court that we in fact -- the reason I stated on the record
25 I believed this court had subject matter jurisdiction under

1 1334 was that the estate continues to have an interest in
2 potentially obtaining proceeds of these policies and in that
3 situation I would add, although it's not before the Court
4 immediately, that in the lift stay motion I reached agreement
5 with Mr. Kirschner's counsel that I am to put on the record that
6 we must provide him notice and give him an opportunity to be
7 heard if he wishes to be heard regarding any compromise
8 precisely because he recognizes that that interest is one of
9 import to him and, of course, we have no difficulty with that.

10 The Court did recognize as I had neglected to in
11 my moving papers, but did remember last night, that the plan
12 confirmation order in fact dealt with the lift stay issues that
13 were raised, but I don't think that that changes the Section
14 1334 issue and I don't think that the Section 1334 basis for
15 jurisdiction --

16 THE COURT: No, I'm not --

17 MR. GOLDMAN: Yeah.

18 THE COURT: I agree with you. I'm not -- and my
19 holding is not based on a finding that I lack jurisdiction,
20 only -- it only reflects that it's another factor in the
21 conclusion I reached that under the substantial overlap cases
22 the underlying basis for that doctrine would apply here, which
23 is that as bankruptcy cases end there's kind of a fade-in role
24 the Bankruptcy Court.

25 And when the case law is already pointing you to

1 go to the other court, that's another factor that just increases
2 my inclination to send it to the other court.

3 MR. GOLDMAN: I understand, Your Honor. I would
4 add -- I would recognize, as we all must, the brave new world
5 of post-confirmation jurisdiction as it is, but I would add
6 further and would stress for the Court -- Your Honor, you have
7 acknowledged, I think, all of as I said the facts that I would
8 have reported to you in respect of our preliminary injunction
9 motion. The one which I think you've also acknowledged earlier
10 in these arguments is that we are -- that Axis is, as they say,
11 up to bat.

12 The harm which Judge Cote identified for us as
13 defendants and actions particularly, of course, for the people
14 on whom -- on whose bases I speak who we have usually
15 characterized as the so-called innocent defendants is that we
16 will have disruption which Judge Cote identified as harm that
17 it has to be addressed immediately. Lexington is out. We are
18 facing immense obligations to proceed in these matters and we
19 need to have a lack of disruption of our ability to have a
20 defense mounted on behalf of the defendants.

21 I would add also the Court has identified that
22 Axis is relying and primarily on an interpretation of the word
23 "covered" in its policy language to argue that they can make
24 that determination on their own and ignore the obligation to
25 advance the costs -- defense costs "as incurred" with a

1 concomitant right of access to seek recoupment later on after
2 it is "finally determined" that -- presumptively by a court and
3 not by Axis that the defense costs should not have been
4 advanced.

5 And, of course, as the Court has already
6 acknowledged this is language which has been identified as
7 important as a matter of case law and policy both by Judge Cote
8 and in the Kaslowsky [Ph.] case.

9 We face that concern now. We face the need for
10 the Court and not Axis to determine their obligation to advance
11 defense costs. It is not just because they say so. We face
12 the need now for a determination that it is covered as we have
13 identified in our moving papers and, of course, the Court is
14 clearly familiar with them. The case law is consistent that it
15 is simply a question of looking to see whether the issue in
16 dispute fits within the policy. This is a securities
17 litigation. It is expressly with an ensuring agreement (a) the
18 word "securities litigation" is there. If this was a medical
19 malpractice case against one of these people it'd be an entirely
20 different policy, but that's not the issue. That's what
21 coverage is all about. So we believe, Your Honor, that we have
22 merited or established a basis to proceed with the preliminary
23 injunction.

24 As the Court is well aware, we proceeded in the
25 manner that -- of a preliminary injunction as had happened in

1 Worldcom. We believe we have the basis to prevail. We believe
2 we've shown the necessary likelihood of success to do so and
3 given that we are going to face an almost immediate disruption
4 in defense efforts, we would ask the Court now to enter the
5 preliminary injunction with the understanding that we would
6 then be able to address any further issues that the Court has
7 at a later time.

8 Your Honor, my co-counsel reminds me that to the
9 extent that the Court is concerned about issues attendant --
10 dealing with the underlying merits, which we do not believe are
11 necessary to address in this situation, it is possible for the
12 Court to stay such portions of this proceeding.

13 As the Court is aware, this is a request for
14 partial relief. That is what Judge Cote was looking at. It's
15 not a request for complete relief. It's a request for
16 advancement. Thank you, Your Honor.

17 THE COURT: Okay.

18 MS. GILBRIDE: Your Honor, in view of the Court's
19 ruling on the prior motion, I believe that this issue of
20 advancement should be left for another court. Since Your Honor
21 has deferred this litigation to another court, we're clearly
22 going to be in front of another court on this coverage issue
23 and I think in view of the Court's ruling on the director
24 defendants motion that the Court should not rule on the
25 preliminary injunction hearing before it.

1 Be that as it may, with respect to the preliminary
2 injunction, we think that there's a very high standard that the
3 insureds must get past in order to get a preliminary injunction
4 with respect to defense costs. We don't think they've even come
5 close to satisfying that. They have not established
6 irreparable harm. They've not even tried to establish
7 irreparable harm.

8 We don't think that they can establish the
9 likelihood of success on the merits. Whether it's a substantial
10 likelihood or not, you know, we believe that it would be a
11 substantial likelihood that they have to establish because we
12 do believe that this is a mandatory injunction that they're
13 seeking and seeking to change the status quo. The status quo
14 right now and has been for the past year that Axis has denied
15 coverage for this case.

16 With respect to the merits of Axis's coverage
17 position, the policy language before Your Honor that's at issue
18 in this hearing is not the language that was before the Court
19 in the Worldcom hearing or in any of the -- the Kaslowsky
20 hearing. It was not the language that was at issue in any of
21 those cases.

22 Axis's language clearly states that they have to
23 advance only covered defense costs and the argument that's being
24 advanced by the insureds simply ignores that language. There's
25 another section of the policy --

1 THE COURT: Well, I think they're saying that if
2 you interpret it the way Axis wants then, in fact, the other
3 language that you're -- I think you're about to quote to me --
4 would be superfluous, which is, you know, fundamental contract
5 interpretation doctrine that you should never render another
6 provision superfluous, but --

7 MS. GILBRIDE: I think if you look at the entirety
8 of Section (d) it's clear that that language is not superfluous.
9 It starts out by saying that Axis will advance covered defense
10 costs. It then goes on to talk about if Axis advances defense
11 costs and ultimately they're not covered that they're ripe --
12 they're subject to recoupment by Axis. That's for the situation
13 where there is an exclusion upon which an insurer reserves
14 rights, for example, a fraud exclusion that requires an
15 adjudication of fraud. In that circumstance, the insurer would
16 reserve rights subject to a final adjudication of fraud and
17 then seek to recoup those defense costs at the end of the
18 litigation of the underlying case.

19 Section (d)(3), which is the allocation provision,
20 must also be considered in this context and the allocation
21 provision clearly says that if there's a dispute as to covered
22 and uncovered claims, the parties have to exercise best efforts
23 to come to a determination. But if they cannot, then Axis must
24 only advance undisputed defense costs and --

25 THE COURT: I probably opened up a can of worms,

1 because I -- not that -- I'm not fascinated by these contra-
2 interpretation points, but because I think the ultimate issue
3 here is -- well, they're not making a motion for summary
4 judgment based on interpretation of the insurance policy. It's
5 his motion for an injunction, so --

6 MS. GILBRIDE: I --

7 THE COURT: -- I understand.

8 MS. GILBRIDE: Okay. So, Your Honor, our position
9 is that based on your prior ruling, we don't believe that Your
10 Honor should rule on this motion for preliminary injunction,
11 but if you do, we don't believe that they've satisfied the
12 procedural threshold for recovery under Rule 65.

13 If Your Honor was so inclined to grant relief our
14 position is that Axis would request that there a bond
15 established by the insureds that are seeking this relief that
16 would provide some assurance for Axis to recover in the event
17 that ultimately at the end of the day Axis prevails in its
18 coverage position.

19 THE COURT: Okay.

20 MS. GILBRIDE: Thank you, Your Honor.

21 MR. GOLDMAN: I will not repeat myself.

22 Your Honor, two items; (1) the papers make this
23 point clear. If Axis', I would say, strained interpretation of
24 the word "covered" were considered by the Court to be a valid
25 interpretation that would merely create an ambiguity we are

1 right in the situation of the Adelphia Regis case. That
2 ambiguity should be construed in favor of the insured but in
3 any event what we would like to stress for the Court is that
4 the urgency given that the Lexington policy exhausted in mid-
5 July of not having a disruption of the defense costs or the
6 reason we've sought injunctive relief and the language -- we
7 would be very happy to have the Court refer the underlying
8 coverage dispute that we will undoubtedly have with Axis and
9 the duty of theirs to step up and ultimately pay the covered
10 policy referred to Judge Lynch but we are requesting that this
11 Court rule on our preliminary injunction at this time in our
12 favor in order to avoid a disaster.

13 THE COURT: All right.

14 MR. GOLDMAN: Thank you, Your Honor.

15 THE COURT: Okay. Did someone else want to speak?

16 MR. EISEN: Your Honor, Norman Eisen from
17 Zuckerman, Spaeder on behalf of the officer defendants who are
18 the indicted defendants as well. I'll be very brief.

19 THE COURT: Okay.

20 MR. EISEN: But we joined in the motion and if I
21 may just add a couple of points just to emphasize Mr. Goldman's
22 points which are even more acute as to the three defendants.
23 We are facing trial in March. The trial was continued from
24 October because of the enormous amount of discovery that needs
25 to be reviewed so it is an even sharper dilemma for us. We

1 would submit that the question is the Court having resolved the
2 choice of law question and the applicability of New York that
3 under the Worldcom case it's a straightforward issue. The
4 Court can't split this off in the same sense that the previous
5 advancement questions have by consent come before the Court on
6 a lis se [sic] posture. There's a narrow issue here that the
7 Court can separate off comfortably within the scope of its
8 jurisdiction and refer the rest elsewhere and --

9 THE COURT: Well, I can't refer anything.

10 MR. EISEN: Understood. The rest can go elsewhere
11 but there is an independent basis for the Court to say, I will
12 address this narrow question. It is, given the Court's
13 previous rulings, a straightforward one we think and let the
14 parties go off to resolve the issues where they may. Opposing
15 counsel has made clear that Axis will not pay. It was
16 virtually the first statement that was made. It doesn't
17 believe that this is covered. Months have passed since the end
18 of May when the complaint was filed. These issues have been
19 joined and have been before the Court on motions for almost two
20 months as you know, Your Honor is more familiar with the
21 Worldcom case than I am, there was a substantial lapse of time
22 there while these jurisdictional issues were resolved and I
23 think on behalf of all the defendants who are very actively
24 engaged in this civil and/or criminal litigation but
25 particularly the ones who are facing the criminal issues Your

1 Honor would really be exercising the Court's equity
2 jurisdiction to address this narrow question and leave the
3 parties to address the larger coverage issues in another forum
4 and with that I will -- unless the Court has any questions for
5 me I'll be seated.

6 THE COURT: No, that's okay. Thanks.

7 MR. EISEN: Thank you, Your Honor.

8 MR. GOLDMAN: I apologize to the Court. Your
9 Honor, may I ask the Court's indulgence --

10 THE COURT: You get the last word.

11 MR. GOLDMAN: Thank you.

12 I just wanted to add for the Court that I had
13 realized before and should have mentioned that I -- yes, I
14 don't think that referral here is actually the option. The
15 counterclaim is pending. It's my understanding that the Court
16 does not believe at present it lacks subject matter
17 jurisdiction as to the issues raised by the counterclaim and so
18 I would on that basis indicate to the Court that since the
19 counterclaim is pending and I believe the Court does have 1334
20 subject matter jurisdiction that is a basis for the Court to
21 consider the preliminary injunction and grant it.

22 THE COURT: I.E., What you're saying is if I
23 dismiss the adversary proceeding you'd still have a separate
24 proceeding pending?

25 MR. GOLDMAN: Absolutely, Your Honor, that's what

1 the counterclaim is there for.

2 THE COURT: Well, what about the issue about
3 likelihood of success on the merits?

4 MR. GOLDMAN: I believe that we have shown that we
5 would likely be able to prevail on the merits in the manner
6 that Judge Cote has described and as we have discussed at
7 length this morning.

8 THE COURT: Because your argument is I would
9 haven't to get into whether there was a fraud or not because
10 it's simply a matter of contract interpretation.

11 MR. GOLDMAN: Correct, Your Honor, as to the
12 advancement obligation. Ultimately, there will be a
13 determination before Judge Cote --

14 THE COURT: Right, as to the advancement issue.

15 MR. GOLDMAN: Exactly.

16 MR. KLINE: Your Honor, may I just be heard to
17 supplement one point and I apologize. Ivan Kline for Friedman
18 & Wittenstein.

19 Part of what's in our counterclaims is the fact
20 that even if Mr. Bennett's knowledge is shown we still have
21 coverage and we can adjudicate that and none of the issues
22 relevant to that will be before any other court because the
23 policy provisions or document relied upon by Axis is simply not
24 part of the policy. The warranty is not part of the policy and
25 a prior knowledge exclusion is not in the policy. Those have

1 nothing to do with Mr. Bennett's knowledge and will not be
2 adjudicated anywhere else, there will be no discovery in any
3 other case that relates to those issues. That's what our
4 counterclaims are largely premised on. Even if one assumes
5 knowledge or its shown elsewhere we still have coverage. This
6 Court, really, is the right Court and as of now the only Court
7 that can adjudicate our position on that and those are what
8 support our advancement request.

9 MS. GILBRIDE: Your Honor, thank you for allowing
10 me to have the last word. I hope it is the last word. But,
11 frankly, what I'm hearing is that the insureds want to have
12 their cake and eat it too. Your Honor has shown a disposition
13 to dismissing the action because you believe there's a
14 substantial overlap in the issues. The counterclaims are based
15 on the very same disputed facts and disputed issues that are
16 asserted in our claim.

17 THE COURT: See, let's explore that for a second.
18 They're saying that they're not because for them to win on the
19 -- they're saying this -- advancement of cost issue all I have
20 to do is interpret the insurance policy as to what those
21 provisions that you and I went through mean as opposed to
22 finding that in fact they were triggered. For you to win you
23 have to prevail on both issues. You have to find that they
24 were triggered too. You have to convince the Court that they
25 were triggered.

1 MS. GILBRIDE: Your Honor, in order for them to
2 prevail on their counterclaims they have to show that their
3 claims are covered claims.

4 THE COURT: I know but that begs the question --
5 that has me assuming your interpretation of the contract is
6 right.

7 MS. GILBRIDE: Well, Your Honor, you only get to
8 that interpretation -- I think in order to get to that issue
9 you need to determine whether or not the underlying claims --
10 it's the cart and the horse here. I mean --

11 THE COURT: But why is that? Why would I need any
12 discovery as to what any of these defendants knew about the
13 alleged fraud if in fact the duty to advance defense costs is
14 something that has to wait for -- I'm sorry -- doesn't have to
15 -- your client's being relieved of the duty to advance defense
16 costs has to await a final determination on the merits that
17 it's a funding mechanism as opposed to an ultimate liability
18 mechanism.

19 MS. GILBRIDE: But, Your Honor, our position is
20 that it is --

21 THE COURT: Well, I know that's your position but
22 in terms of deciding the issue it doesn't really implicate the
23 substantial overlap doctrine. I'm not sure it does.

24 MS. GILBRIDE: I believe it does, Your Honor, and
25 I believe it's fundamentally unfair --

1 THE COURT: But why?

2 MS. GILBRIDE: Because basically our position is
3 that the claims are not covered and you have to determine that
4 by looking at the underlying acts and finding whether or not
5 the warrant applies and whether or not the prior knowledge
6 exclusion applies. I think that you can't do one without the
7 other, Your Honor.

8 THE COURT: They could prevail without that it's
9 just that only you have to win on both points. They could win
10 on one.

11 MS. GILBRIDE: But for them to win on one there
12 has to be an excision of a word from the insurance policy, the
13 word "covered" --

14 THE COURT: Well, but again, that's the --

15 MS. GILBRIDE: -- and I don't think Your Honor --
16 respectfully, I don't think Your Honor can make a determination
17 without getting into the facts on that regardless --

18 THE COURT: But what facts? I mean either it's
19 not ambiguous and it's based on the plain meaning of the
20 document or it's somewhat ambiguous but construed against the
21 insurer or the insurer is able to say, well, even if you
22 construe it against me it's still --

23 MS. GILBRIDE: I think in order to grant a
24 preliminary injunction, Your Honor, you have to get the
25 substantial likelihood of success on the merits and I don't

1 think --

2 THE COURT: But isn't -- again, I confess what --

3 MS. GILBRIDE: Mr. Goldman.

4 THE COURT: No. No, that was --

5 MS. GILBRIDE: Mr. Kline. Mr. Eisen.

6 THE COURT: No. I'm going somewhere else.

7 MS. GILBRIDE: Okay.

8 THE COURT: When I read your argument about the
9 defendants taking inconsistent positions I kind of dismissed
10 that right away because it was in the context of the motion to
11 dismiss and, clearly, Mr. Walsh's clients weren't taking
12 inconsistent positions. So I didn't even think about it
13 whether they were inconsistent or not but I'm not sure they are
14 inconsistent. I mean Mr. Walsh's clients want your claim
15 dismissed but even if you hadn't made that claim wouldn't any
16 beneficiary of this policy have a right to start a lawsuit
17 saying that you've wrongfully failed to pay?

18 MS. GILBRIDE: Yes, of course --

19 THE COURT: Now, I thought that wasn't truly ripe
20 -- when I came into this I thought that wasn't truly ripe in
21 the real term of ripeness because other than saying you want me
22 to determine whether you don't have to pay you hadn't said, we
23 won't pay, but I thought I heard you say at the beginning of
24 this hearing --

25 MS. GILBRIDE: We said --

1 THE COURT: I'll do the talking.

2 MS. GILBRIDE: Sorry.

3 THE COURT: I thought I heard you say at the
4 beginning of this hearing, no matter whether you dismiss or not
5 we won't pay and that makes it ripe to me, I think. I mean if
6 Axis is saying literally today, we're not going to go back and
7 rethink this and consider whether -- now that Judge Drain is
8 not going to decide for us whether we have to pay or not,
9 whether we're going to take the risk of not paying which, you
10 know, is certainly a legitimate thing for an insurer to do.
11 It's one thing to act unilaterally, it's another thing to ask a
12 Court for a determination of whether they're acting properly.
13 At this point Axis would be acting unilaterally. That raises
14 some fairly serious issues, you know, and maybe creates
15 potential liability beyond the coverage so -- but if you're
16 telling me today Axis has already made that decision, it's
17 going to act unilaterally and not withhold the money, then this
18 is ripe.

19 MS. GILBRIDE: Your Honor, I can't make a
20 representation one way or the other about what Axis will do
21 because we didn't know what your ruling was going to be and so
22 --

23 THE COURT: Well, no, but I thought you told me --
24 I mean I don't have a court reporter here, we're on electronic
25 transcript -- at the beginning of the hearing that --

1 MR. BORGEEEST: Your Honor, Wayne Borgeest on
2 behalf of Axis. May I be heard briefly?

3 THE COURT: On behalf of?

4 MR. BORGEEEST: Axis.

5 THE COURT: Okay.

6 MR. BORGEEEST: If I may, Your Honor, Axis denied
7 coverage over a year ago so the company staked out its position
8 well over a year ago. The position --

9 THE COURT: Yes, but at that point it didn't
10 really matter. I mean you could always change your mind --

11 MR. BORGEEEST: Well, no --

12 THE COURT: No one was asking you for money then.

13 MR. BORGEEEST: Well, I think it did matter. I
14 think that counsel was free to bring --

15 THE COURT: Do you really want to say that?

16 MR. BORGEEEST: Counsel was free to challenge --

17 THE COURT: I mean --

18 MR. BORGEEEST: Your Honor, Axis did not get so
19 much as a letter disputing the denial.

20 THE COURT: But --

21 MR. BORGEEEST: I think what the counterclaim
22 defendants are saying is that for purposes of your jurisdiction
23 it's okay for them to prove that their clients were wrongly
24 treated but in denying us our prosecution of our complaint for
25 declaratory judgment of no coverage you're not allowing us to

1 prove that we are correct in our position and that obviously is
2 an absurd result.

3 THE COURT: It's not I don't think. I'm sorry, I
4 beg to differ because it's two different issues.

5 MR. BORGEEEST: No, but we filed an action for a
6 declaration of the Court --

7 THE COURT: Right.

8 MR. BORGEEEST: -- that there's no coverage for
9 these individual insureds.

10 THE COURT: I understand and --

11 MR. BORGEEEST: They have counterclaimed saying
12 that there is coverage for their insureds.

13 THE COURT: No, they have not. They have
14 counterclaims saying that your client has to advance defense
15 cost.

16 MR. BORGEEEST: That's correct.

17 THE COURT: And they have a different
18 interpretation of the contract than your client has.

19 MR. BORGEEEST: But, Your Honor.

20 THE COURT: They say that that provision is a
21 funding mechanism subject to recoupment or reimbursement. You
22 say it's a coverage issue.

23 MR. BORGEEEST: With all due respect, Your Honor,
24 Your Honor cannot --

25 THE COURT: With all due respect I read it and

1 that's what it says.

2 MR. BORGEEEST: But, Your Honor, with all due
3 respect the Court cannot find that there is a funding
4 obligation without finding that there is coverage.

5 THE COURT: I disagree completely.

6 MR. BORGEEEST: Well, then we have a disagreement
7 but --

8 THE COURT: I can't find that there is no funding
9 obligation without finding that the insurer has no underlying
10 liability but in terms of the issues as to the meaning of the
11 contract and what the provisions mean as far as coverage and
12 the reference to "finally determined," that has nothing to do
13 with the evidence that's going to be coming out in the
14 litigation in the district court.

15 MR. BORGEEEST: But, Your Honor, how can the Court
16 find that there's a funding obligation in the face of a claim
17 which you now want us to take over to another courthouse where
18 we are going to prosecute the claim to find that there is no
19 coverage?

20 THE COURT: Oh, no, this litigation would have to
21 be limited to a fairly narrow set of issues. It would not get
22 into that issue.

23 MR. BORGEEEST: Your Honor, we're being put in a
24 very awkward position. We responded to the motion to dismiss
25 by saying that we would litigate our coverage issues in a

1 narrow fashion without burdening the underlying securities
2 litigation. Your Honor has given an indication that you're
3 inclined to reject that --

4 THE COURT: Because it wouldn't happen.

5 MR. BORGEEEST: -- because of the overlap.

6 THE COURT: Right.

7 MR. BORGEEEST: If there's overlap for our claim
8 for a declaration of no coverage there necessarily must be
9 overlap with their declaration of some claim that funding in
10 the absence of a determination of coverage.

11 THE COURT: All right. I thought you were going
12 to stand up to say something completely different which is that
13 this isn't ripe --

14 MR. BORGEEEST: I'm sorry, Your Honor.

15 THE COURT: -- and the insurer has really not made
16 up its mind but I think we're just repeating the same argument.

17 So is the insurer saying it's not going to pay or
18 not?

19 MR. BORGEEEST: Your Honor, the insurer issued a
20 denial letter well over a year ago that went unchallenged.

21 THE COURT: I understand that but there's -- I
22 also understand that there's a big difference and potentially a
23 legal difference as far as the insurer's liability. When push
24 really comes to shove and the request is made because they need
25 the money, they've gone through the first layer of excess that

1 it really won't fund because that's when the damages start and
2 that's when penalties start for the insurer. So that's a very
3 serious decision for an insurance company to make.

4 MR. BORGEEEST: It is and that's the reason why we
5 filed a declaratory judgment action --

6 THE COURT: I understand and that's why I thought
7 the insurer was deciding to act not unilaterally but to try to
8 get a judicial determination and I don't fault you for that.
9 That's a good thing. That's what responsible parties do but,
10 although I had not decided this until preparing for this
11 hearing, it's not going to work here. I can't give you that
12 determination. So now you have to decide whether you're going
13 to act unilaterally, in which case I think this motion is ripe
14 or not and I'm happy to give you a little time to decide that.

15 MR. BORGEEEST: Your Honor, we're prepared to
16 litigate the issue of coverage. That's why we're here. The
17 contract itself by its terms --

18 THE COURT: You lost on that point.

19 MR. BORGEEEST: Okay. Let me turn to another point
20 then.

21 THE COURT: Okay.

22 MR. BORGEEEST: The contract by its terms gives
23 Axis the unilateral right to determine how much of the defense
24 costs are covered and how much it will pay. Contractually, it
25 gives Axis that right unilaterally.

1 THE COURT: I am happy to determine those issues
2 here -- those contract interpretation issues if you're telling
3 me that if I don't determine them you're going to withhold
4 coverage.

5 MR. BORGEEEST: Your Honor, we came here, filed
6 this action prepared to litigate the contract issues. All
7 we're saying is you can't litigate some and not all.

8 MS. GILBRIDE: Your Honor, you're asking us to go
9 to another courthouse to litigate this.

10 THE COURT: No, I'm asking you to tell me whether
11 in fact your client's going to pay or not. If they're not then
12 I think this is ripe. If they are going to advance defense
13 costs or they're considering it, it's either not ripe or I'll
14 give your clients some more time to consider this issue.

15 MS. GILBRIDE: Our position has consistently been
16 that we're not going to advance defense costs in the absence of
17 a judicial determination that we must. Our policy says that we
18 -- it says that we must advance covered defense costs.

19 THE COURT: Okay. Then I believe this issue is
20 ripe. So I have been persuaded -- Mr. Goldman has persuaded me
21 that I should dismiss the underlying action brought by Axis but
22 keep the counterclaim on the docket.

23 It seems to me as a practical matter it may make
24 sense to move to withdraw the reference of this matter but
25 that's not something I can do. I also need to know -- because

1 there's no record here really -- as to when these costs are
2 going to kick in.

3 MR. GOLDMAN: Your Honor, they've already kicked
4 in. We have bills that were submitted to Axis approximately
5 two weeks ago for July time because the Lexington policy
6 exhausted with the payment of June time so they have the bills,
7 we're waiting for payment.

8 MR. KLINE: I don't believe this is a dispute,
9 Your Honor.

10 MS. GILBRIDE: That's correct.

11 THE COURT: There are outstanding bills? How
12 much?

13 MS. GILBRIDE: Approximately \$2 million has been
14 submitted to us in the past month.

15 THE COURT: And when were they submitted?

16 MS. GILBRIDE: Plus, there's been a settlement
17 demand tendered to the carrier.

18 THE COURT: When were the bills submitted?

19 MS. GILBRIDE: Over the course of the last several
20 weeks.

21 THE COURT: Well, we're really just talking about
22 the defense costs here; right? Because the settlement demand
23 is going to be subject to a fairness hearing, notice to the
24 Refco Trustee and the like. That money is not going to come
25 out-of-pocket for quite some time.

1 MR. GOLDMAN: That's correct, Your Honor.
2 Obviously, Judge Lynch would have to have an approval on that
3 in accordance with Rule 23.

4 THE COURT: What is your response on the bond
5 point?

6 MR. GOLDMAN: In brief, Your Honor, it turns the
7 policy upside down. They're asking us to be their insurer.
8 The policy terms are express. I don't think there's any
9 difficulty interpreting it as exactly as the Court has
10 identified it, a funding vehicle. It would be the same as
11 every --

12 THE COURT: Well, no, I was just identifying the
13 issue not -- I wasn't --

14 MR. GOLDMAN: I understand. I understand, Your
15 Honor. It would be the same as asking every automobile
16 accident person to bond the costs until the insurer decides
17 whose liable. It doesn't work that way. That's what insurance
18 is for. That's what the particularity of an insurance contract
19 is all about. It's their obligation to assume that risk and
20 contractually we would assert we will convince this Court that
21 they assume precisely that risk with the language that they
22 drafted.

23 THE COURT: Is the discovery -- has there been any
24 change in the intensity of the litigation in terms of the
25 incurrence of legal fees and the like?

1 MR. GOLDMAN: I'm sorry, the securities
2 litigation, Your Honor?

3 THE COURT: Yes.

4 MR. GOLDMAN: Yes, discovery started.

5 THE COURT: And there's no like hiatus or anything
6 like that, it's moving ahead?

7 MR. GOLDMAN: No. We're not in hiatus world, Your
8 Honor. We're in an incurring debt world.

9 THE COURT: And you say the criminal trial is now
10 on for March?

11 MR. EISEN: Yes, Your Honor, and there has been, I
12 think -- because we were set initially for October there was a
13 very intense period which I think is some of what's in the
14 pipeline as a result of the continuance. I know I was able to
15 take my summer vacation so I think that there has been some
16 lessening there, although obviously we're going to need to get
17 ready for that as well.

18 THE COURT: You've agreed upon the amount of the
19 legal bills that have been submitted?

20 MS. KIM: Your Honor, the practice has been that
21 the parties simply submit the bills to the carrier and there
22 has not been any requirement of consent or --

23 THE COURT: No, I'm not talking about consent,
24 just literally what the amount is of the bills.

25 MR. KLINE: Your Honor, no one of us would have

1 any way to know the total because --

2 THE COURT: No, I thought you might have conferred
3 among --

4 MR. KLINE: No. We only see our own. Only Axis
5 would know the --

6 MS. KIM: Yes. All we do, Your Honor, is submit
7 the bills and we understand it's a first come/first serve basis
8 and then they let us know when it's exhausted. That's exactly
9 what happened with the U.S. Specialty and the Lexington
10 policies.

11 THE COURT: But you say it's about \$2 million?

12 MS. GILBRIDE: Yes, Your Honor. I mean we've just
13 gotten the bills in so they haven't been the subject of any
14 sort of a review for what's been incurred but that's the gross
15 amount.

16 MR. CASHMAN: Your Honor, I'm sorry, I haven't
17 spoken yet. This is Richard Cashman. We represent one of the
18 officer defendants, Philip Silverman, and I just wanted to
19 respond to Your Honor's question and that is there are bills
20 that are coming as well because there has been a lot of
21 activity in these cases.

22 MS. KIM: What do you recommend [sic]?

23 THE COURT: Well, it seems to me that on the issue
24 of the contract interpretation one could get to that issue very
25 quickly. It's a matter of contract interpretation and

1 consequently unless someone has a different view I should not
2 be thinking here about a lengthy injunction and if it is to be
3 teed up here it should be teed up promptly.

4 I continue to think, although this is beyond my
5 power, that given the existence of a securities action and the
6 inevitable tie-ins to settlements that a district judge might
7 want to have the reference but that's not for me to decide.

8 I also know that law firms generally are prepared
9 to wait a little bit for payment of their bills. So I'm really
10 focusing on the ones that have been billed and not on some sort
11 of general green light for anything coming due over the next
12 several weeks or months but I am prepared to conclude on the
13 basis of my review of the general principles set forth in the
14 Worldcom case with regard to how courts look at provisions in
15 indemnity policies in respect of the advancement of defense
16 costs as well as the particular language at issue here on Page
17 8 of the policy that as far as the merit aspect of a motion for
18 a preliminary injunction is concerned there is either a
19 substantial likelihood of success on the merits or -- and I
20 strongly emphasize the "or" because this is more where I'm
21 focusing -- sufficient questions going to the merits which in
22 light of the balance of the harms here would mean that on the
23 issue of the merits the movants have sustained that prong of
24 their request for a preliminary injunction going to the harms,
25 although it is asserted and I accept this that certain of the

1 defendants are wealthy individuals. The amount of the defense
2 costs here -- \$2 million -- following upon the primary
3 carriers' coverage limits being exceeded tells me that these
4 are extremely substantial defense costs that need to be
5 incurred as part of this schedule that's been set out by the
6 various courts; the criminal court in particular but also the
7 district court in the securities litigation and that to run the
8 risk of not having counsel proceed or to substantially cut back
9 upon their efforts because of unpaid bills is a tremendous
10 potential harm particularly in a criminal context and I note
11 that as Judge Gerber has in the Delta case, there is a
12 significant distinction between an indictment and a conviction
13 and the criminal trial is at the trial stage, not the Appellate
14 stage.

15 That leaves, I believe, the issue initially raised
16 by counsel for Axis and pressed by counsel for Axis that a
17 ruling granting the request for a preliminary injunction is
18 fundamentally inconsistent with a ruling dismissing Axis'
19 underlying case which obviously I just issued. I do not
20 believe that it is inconsistent with that ruling or unfair to
21 Axis. As I noted before, for Axis to prevail in its
22 declaratory judgment action it needs to prove two things; it
23 needs to prove that it's interpretation of the contract -- the
24 insurance policy -- as well as potentially the related warranty
25 is the right interpretation, the correct interpretation. That

1 is not a matter that substantially overlaps with litigation
2 anywhere else. In particular, it doesn't substantially overlap
3 with litigation in the district court and the securities law
4 action or with litigation in the criminal action. However, if
5 Axis' interpretation of the contracts as they apply to the duty
6 to advance defense costs is incorrect then the plaintiffs on
7 the cross-claim or the counterclaim prevail as far as the
8 defense costs advancement issue is concerned. Therefore, it
9 seems to me that those issues -- those contract interpretation
10 issues -- are discrete and can be decided by me. As I noted,
11 Axis needs to win two things in order to not advance defense
12 costs, however, in addition to having its interpretation of the
13 contract prevail it also has to convince a Court that the
14 exclusions or its right to rescind or its right under the
15 warranty, so-called, have been triggered and that is what
16 overlaps as I have previously found with the district court
17 litigation in the criminal case but it seems to me the
18 plaintiff's claim here -- and the only plaintiffs that would be
19 left would be the counterclaim plaintiffs -- is not subject to
20 that problem and can go forward. As you can tell from my
21 earlier remarks, I toyed with the idea of somehow putting this
22 off or delaying it so that the whole matter could be joined
23 with the district court litigation because I think that in
24 terms of settlement and the like that may make sense but that's
25 not something I can do and I do have an obligation to exercise

1 my jurisdiction unless it's withdrawn from me except where the
2 law requires me not to as in the substantial overlap case law
3 and so, there having been a counterclaim filed which can
4 survive as the only claim in this adversary proceeding, I have
5 jurisdiction to determine the motion for a preliminary
6 injunction. I don't believe that it is unfair to exercise that
7 jurisdiction here or inequitable and, therefore, the equitable
8 relief sought can and should be granted.

9 There has been a request for a bond to be posted
10 but as Mr. Goldman said and as I believe the case law provides,
11 that would be tantamount to advancing one's own defense costs
12 and contrary to the case law.

13 So let me be clear as I said before, it seems to
14 me that the injunctive relief that I'm ordering here should be
15 limited to bills that are outstanding and I believe this is the
16 case but I want to be clear, I am doing nothing more than
17 saying that. The insurer, Axis, is directed to advance defense
18 costs based upon the beneficiary's definition of or
19 interpretation of the provisions on Page 8 requiring
20 advancement, i.e., if there are other provisions or to the
21 extent there are other provisions of the insurance policy that
22 apply to the advancement of defense costs other than the issue
23 that's been teed up here, i.e., whether there needs to be a
24 final determination or not, I'm not overwriting those
25 provisions. This just goes to the dispute as to whether there

1 needs to be a final determination of coverage or not related to
2 the advancement of defense costs. So, for example, if Axis has
3 the ability to review for reasonableness or the like under the
4 insurance policy that's not being overridden by this ruling.
5 The only thing that Axis is being directed to do is to comply
6 with the provision that requires defense costs to be advanced
7 subject to the final determination and we should schedule the
8 final hearing on this promptly which I view to be a matter that
9 can be decided based on review of the contract unless someone
10 else tells me otherwise.

11 The parties have obviously done a lot of briefing
12 on the merits already of that issue.

13 MR. GOLDMAN: Yes, Your Honor.

14 THE COURT: So if we did this --

15 MR. GOLDMAN: Your Honor, just one moment.

16 [Pause in proceedings.]

17 MR. GOLDMAN: Your Honor, having conferred with
18 the small group of co-counsel we have here I think our
19 assessment is certainly if Axis wishes to file in a further
20 brief on the contract interpretation issue which we have always
21 felt is the narrow issue we have been presenting we would then
22 file a responsive brief and we would schedule with the Court's
23 cooperation as early as the latter part of September for a
24 further hearing on this.

25 THE COURT: It would be on a motion for a summary

1 judgment though; right?

2 MR. GOLDMAN: Yes, Your Honor, we could file a
3 motion for summary judgment.

4 THE COURT: Or, I guess, a motion to dismiss. It
5 could be either one. It would really be a motion -- well --

6 MR. GOLDMAN: We'll do a motion for partial
7 summary judgment. That's what we're going to do.

8 [Other attorneys commenting in the background]

9 MR. GOLDMAN: That's what we're going to do,
10 narrowed to the issues that the Court has identified we are
11 focused upon.

12 MS. GILBRIDE: Your Honor, respectfully, on behalf
13 of Axis we intend to file an immediate appeal of Your Honor's
14 ruling today.

15 THE COURT: Okay.

16 MS. GILBRIDE: So we would ask that that be
17 factored into whatever briefing schedule is going to be
18 established. We understand we have to do that within the next
19 ten days and we would ask that the order ordering us to advance
20 defense costs be deferred until we can get an appeal filed with
21 the district court.

22 MR. GOLDMAN: I understood that to be a request
23 for a stay?

24 THE COURT: As long as it's an expedited appeal.

25 MS. GILBRIDE: Oh, we intend to file it, you know,

1 as quickly as we can.

2 THE COURT: No, no, that you request expedited
3 treatment --

4 MS. GILBRIDE: Yes, we will. We will, Your Honor.

5 THE COURT: All right. I mean I could actually --
6 I have a lot going on at the end of September and beginning of
7 October in various cases but I could give you October 12th just
8 for your own purposes and you could tell the district court
9 that.

10 October 12th. Friday.

11 MR. GOLDMAN: Is that after the NCBJ? I believe
12 it is actually or is it during?

13 THE COURT: I don't know.

14 MR. GOLDMAN: It doesn't --

15 THE COURT: If it is -- I wasn't going to be going
16 to that.

17 MR. GOLDMAN: I gathered.

18 THE COURT: But I could give you that date.

19 MR. GOLDMAN: One moment if I may, Your Honor.

20 THE COURT: But I am inclined to grant this
21 request. It seems to me while it's important to deal with the
22 billing issue -- for a lot of reasons I'm inclined to grant
23 this request.

24 MR. GOLDMAN: And Your Honor let me make one
25 comment and then my co-counsel will speak if I may. We have so

1 much expense coming up the fear is that this not be
2 characterized as a stay that the Appellate Court presumes can
3 be continued --

4 THE COURT: No, I don't -- that's why I asked for
5 --

6 MR. GOLDMAN: -- I don't know that ten days
7 doesn't matter but six weeks does.

8 THE COURT: That's why I requested an expedited --
9 that we'd be conditioning it upon an expedited appeal.

10 MR. KLINE: Your Honor, can I suggest it might be
11 more appropriate -- we don't mind if they're given ten days to
12 pay but it should be incumbent upon them to get a stay from the
13 district court.

14 THE COURT: But you can do that in ten days.
15 That's easy to do.

16 MR. KLINE: Right. But absent a stay from the
17 district court they should be required to follow Your Honor's
18 order and pay otherwise they'll just file and say we don't have
19 to pay.

20 THE COURT: My view is this issue could be well
21 teed up for the district court within ten days and I think
22 that's what counsel intended.

23 MR. KLINE: I think with all respect it should --

24 THE COURT: So I will -- it's stayed for ten days
25 but that's more than sufficient time to put in an appeal.

1 MR. GOLDMAN: I understand.

2 THE COURT: I know lawyers can wait ten days on
3 payment of their bills but I'm also as I said very cognizant of
4 the fact that the bills are very large and they're going to be
5 increasing in the future and that this issue on the merits
6 really needs to be decided very quickly -- this contract
7 interpretation issue -- and so I'm telling you all that I would
8 be free on October 12th to hear it and I think that may be
9 useful for the district court also but I'm not going to impose
10 a briefing schedule on you because the next step of this is
11 going to be at the district court but as everyone now
12 understands that step has to result in some action by the
13 district court within the next ten days or my stay is going to
14 be gone. The stay that applies now is going to be gone.

15 MR. GOLDMAN: That's fine.

16 Your Honor, we will be bringing on a summary
17 judgment motion probably before the district court -- partial
18 summary judgment -- but that --

19 THE COURT: All right. But I think the October
20 date gives people -- particularly given all the work that they
21 have done on it and, I'm sure, will be doing on it, people will
22 be reciting these provisions of the insurance agreement in
23 their sleep and will be well enough prepared for a hearing in
24 October.

25 MR. GOLDMAN: That already has happened.

1 THE COURT: Okay. That leaves the stay motion.

2 MR. GOLDMAN: The stay motion and I --

3 THE COURT: All right. But before we go to that
4 you'll need to give me an order --

5 MR. GOLDMAN: Yes.

6 THE COURT: -- and you should do it promptly
7 because that's what's going to start their appeal obviously and
8 that needs to go forward promptly so --

9 MS. GILBRIDE: There would be two orders, Your
10 Honor, right?

11 THE COURT: Well, Mr. Walsh is going to be me an
12 order dismissing the main -- the adversary claim brought by
13 Axis and Baker & Hostetler is going to give me an order
14 granting the preliminary injunction in connection with their
15 cross-claim or counterclaim. Excuse me.

16 MS. GILBRIDE: Your Honor, if I heard you
17 correctly the ten days would then start to run from the date
18 that you sign that order?

19 THE COURT: Well, from the entry of the order.

20 MS. GILBRIDE: Right.

21 THE COURT: No, no, I'm sorry, the ten days on the
22 --

23 MS. GILBRIDE: To get an expedited --

24 THE COURT: For the injunction? Yes.

25 MS. GILBRIDE: Yes.

1 THE COURT: Yes.

2 MR. GOLDMAN: All right, Your Honor, just because
3 we have discussed the stay issue at some length I have nothing
4 further to add. I only wanted to make one -- I'll call it the
5 tangential point -- one of the reasons why we have sought the
6 stay modification to the extent it was necessary in light of
7 the plan confirmation order was precisely because demands to
8 the insurers need to be made under cooperation provisions in
9 many of these policies for them to put it in line for payment.

10 Obviously, they make their determinations in response but I
11 certainly did -- that was a primary reason why we wanted to get
12 this clarification and, of course, it's my understanding that
13 nothing in today's ruling with respect to the preliminary
14 injunction motion changes the fact that we would submit a
15 demand to the insurer. It doesn't mean they're going to pay it
16 obviously but it does mean we have the right to do that.
17 That's in large part what the lift stay motion is all about.
18 We have as I have said agreed we will provide notice to Mr.
19 Kirschner regarding our doing so.

20 THE COURT: Okay.

21 MR. KLINE: Your Honor, Ivan Kline from Friedman &
22 Wittenstein.

23 It's been a long morning and I'll be very brief.
24 Our only point of our response is really we believe it would be
25 more appropriate to make sure that a particular settlement is

1 back before this Court for approval given that this is the
2 Court that has jurisdiction over the policy and has all the
3 insureds before it and no other court has that; whether it's in
4 the context of the stay or not to stay or using your authority
5 under Section 105 is really less important than we simply
6 believe that there should be some mechanism whereby a
7 particular settlement would be subject to this Court's review
8 and approval to make sure that all of the parties' rights
9 including those of the estate and those of other insureds are
10 not being prejudiced in any way and I believe actually in the
11 letter from Axis that was submitted on their reply even
12 suggests that whatever the proposed settlement is would be one,
13 for example, that might prejudice the rights of other insureds.

14 I still don't know what the details are so it's hard for us to
15 comment on that but our point was simply we have no problem
16 with the concept of the stay being lifted to allow for the
17 payment of settlements it's simply that we think it should be
18 in one form or another a particular settlement should be before
19 this Court.

20 THE COURT: Okay. Well, again, I quoted the
21 language in Paragraph 34(c) of the confirmation order which I
22 believe enables the beneficiaries of the policies -- not just
23 the debtor but the other beneficiaries -- to seek and obtain
24 coverage and payments from those policies.

25 Now, it may be that the consequences of doing that

1 will effect the debtor in a way that would require some relief
2 here in terms of either a settlement or 9019 or the other
3 provisions of the plan but it's hard for me to conceive what
4 those would be and it seems to me that as long as there is
5 advanced notice, not retroactive notice but advanced notice of
6 any proposed settlement, that the plan administrator on behalf
7 of their estate will be able to protect the estate's rights and
8 that's, I gather, what Mr. Kirschner has concluded also.

9 It seems to me that the other beneficiaries, to
10 the extent the settlement involves insurance or -- well, I'll
11 leave it at that. I mean obviously there are contribution
12 issues, too, but to the extent a settlement involves insurance
13 it should get notice of a settlement as far as approval by a
14 district court is concerned in the MDL, for example. So I
15 think as long as there is proper notice to other effected
16 parties that your concerns are taken into account.

17 MR. KLINE: Your Honor, could I just ask then that
18 the order that they submit recite that there must be advanced
19 notice because I believe that the order they submitted calls
20 for post-disbursement notice --

21 THE COURT: You're right.

22 MR. KLINE: -- which is of no use for the
23 settlement

24 THE COURT: It needs to be adequate advance
25 notice.

1 MR. KLINE: And could the other insureds be
2 included in that so that if we wanted to seek relief in this
3 Court we could do so? Frankly, I don't think Judge Lynch will
4 have any interest in hearing the claim of one insured against
5 another. I think Judge Lynch's only concern in a Rule 23
6 approval is fairness to the plaintiffs in the class which is a
7 different issue.

8 So if we could just get that the notices to the
9 plan administrator and the other insureds in advance I think we
10 would withdraw any objection to their motion.

11 MS. KIM: Well, Your Honor, I'd like to know in
12 advance of what because all that we are seeking here is to make
13 sure that the automatic stay is not used as some kind of
14 procedural bar that interferes with the normal course under the
15 insurance policy for the carrier to determine whether or not a
16 settlement is reasonable or not. Obviously, any settlement
17 would be subject to the consent of the carrier and so what I
18 don't want to happen is to be required to give notice before
19 seeking consent or obtaining consent from the carrier -- after
20 the carrier.

21 THE COURT: You're talking about getting advance
22 notice of approval by the court presiding over the litigation?
23 Is that what you're talking about?

24 MS. KIM: Oh, that's fine. We don't have any
25 problem getting advance notice. Of course, we'd be required to

1 give notice to the parties to the underlying litigation. They
2 would get notice just like any other party in terms of
3 obtaining approval before Judge Lynch on any settlement so I
4 just want it to be clear on the record what they're seeking.

5 THE COURT: Well, I was asking you. Is that what
6 you had in mind?

7 MR. KLINE: All I'm asking is whatever advance
8 notice they promised Mr. Kirschner that we get. I don't know
9 what they meant by advance notice to Mr. Kirschner but it must
10 be before disbursements.

11 THE COURT: All right. So you're --

12 MR. GOLDMAN: We have no problem with that, Your
13 Honor. Obviously we will circulate to him and to others an
14 order. We have to have Mr. Kirschner look at it as well but
15 that order won't come in today it will probably come in
16 tomorrow.

17 THE COURT: Okay. That's fine.

18 MR. GOLDMAN: Your Honor, if I may we had
19 submitted to the Court a proposed order and as I review in
20 respect of the preliminary injunction I think it is consistent
21 with the Court's ruling except that I would suggest that we
22 insert -- as it say there, "obligated to pay defense costs," I
23 would insert "ten days after entry of this order."

24 MS. GILBRIDE: Your Honor, you know, I don't have
25 that order in front of me at the moment but I believe that's an

1 order ordering us to advance defense costs on behalf of all
2 insureds not just the remaining insureds, No. 1, and I think
3 there's a reference to future costs in the order as well? I'd
4 like the opportunity to review it before.

5 MR. GOLDMAN: I think what we'll do is give her a
6 copy of what I have in my hands, Your Honor, if that's all
7 right.

8 THE COURT: Well, let me take a look at it first.
9 Let me just take a quick look at it.

10 [Pause in proceedings.]

11 THE COURT: Well, this applies to the defined term
12 "movants" not all the parties.

13 MR. GOLDMAN: Your Honor, just on -- we have no
14 objection to it applying to other insureds, just so the Court
15 understands that.

16 MR. EISEN: Your Honor, if I may, we joined -- the
17 other defendants joined in so if the Court is inclined -- and
18 obviously our situation was part of the Court's reasoning. If
19 the Court is inclined after this order we'd just ask --

20 THE COURT: No, your clients did join in.

21 MS. GILBRIDE: Your Honor, there are no
22 counterclaims asserted on behalf of his clients. There's no --
23 they have not answered, they have not asserted counterclaims,
24 there is no basis for the Court to order advancement of defense
25 costs on behalf of his clients.

1 MR. WALSH: Nonetheless, Your Honor, there is an
2 advancement obligation and it seems completely illogical to
3 make a determination for one and not the other.

4 THE COURT: That's true but it's also -- it's
5 procedurally -- you can make a motion promptly but there's no -
6 -

7 MS. GILBRIDE: They made a motion to dismiss.

8 THE COURT: No, no, they made a motion to dismiss
9 your client's claims but the only motion for a preliminary
10 injunction before me and the only counterclaim before me is --

11 MR. WALSH: We understand that, Your Honor, so if
12 that's what Axis requires that we go through all the procedural
13 --

14 THE COURT: Well, it's what I require.

15 MR. WALSH: Okay. Then we'll do that.

16 THE COURT: And the same for the criminal
17 defendants.

18 MR. EISEN: Your Honor, our joinder in the
19 existing motion --

20 THE COURT: That's not sufficient.

21 MR. EISEN: Just to be clear so what does Your
22 Honor require? That additional counterclaims --

23 THE COURT: On an adversary proceeding basis which
24 is what the counterclaim was you need to start an action for
25 advancement of defense costs and seek preliminary injunctive

1 relief.

2 MR. EISEN: Your Honor, is it sufficient to -- you
3 know, the posture that we were in up to this point was we had
4 joined in the motion to dismiss so there was no pleading
5 requirement for us before today. Pleading is held in -- it was
6 the motion to dismiss the insurers' claims and we did join in
7 the motion for preliminary injunction so --

8 THE COURT: But, procedurally, I'm not comfortable
9 with that.

10 MR. EISEN: Just so I understand the parameters of
11 that, if that is filed around the representation that's going
12 to be filed may we be included or can we within that ten day
13 period of the order are we going to need to submit --

14 THE COURT: No. I think you're going to need to
15 go through the procedural hoops.

16 MR. EISEN: Will that require an additional
17 hearing or can we just submit those -- I only ask that question
18 --

19 THE COURT: I don't know. I'll have to decide
20 that. I don't know. I would find it unlikely but let me read
21 the pleadings.

22 MR. EISEN: Thank you, Your Honor.

23 THE COURT: Okay. They're all different. Your
24 clients, although I doubt it, might be multi-millionaires or
25 multi-multi-millionaires. I don't know. I know one of Mr.

1 Walsh's clients is.

2 MR. WALSH: Was that taking inflation into
3 account, Your Honor?

4 THE COURT: No. No, they're not. They're not.
5 They're not withdrawing it.

6 MS. GILBRIDE: So you could dismiss the action.
7 They're not even parties.

8 THE COURT: No, I said they can start their own
9 action and as part of that adversary proceeding seek injunctive
10 relief.

11 MS. GILBRIDE: It's slightly inconsistent.

12 THE COURT: Well, I've already ruled on that.

13 MR. EISEN: Your Honor, at the risk of delaying
14 things may I quickly suggest another alternative that I think
15 would be easier for the Court which is to allow us the option
16 of intervention as opposed to filing independent adversary
17 proceedings?

18 THE COURT: I'm not aware of such an option.

19 MR. EISEN: Okay.

20 THE COURT: I'm just not. So somehow you need to
21 tee it up so that it's before me as far as an affirmative
22 claim.

23 MR. EISEN: Understood and if we're able to puzzle
24 out another basis that we believe --

25 THE COURT: I'm not precluding you from puzzling

1 out another basis.

2 MR. EISEN: Thank you, Your Honor.

3 THE COURT: Okay. So by movants here -- the
4 defined term "movants" is just your clients; right?

5 MR. GOLDMAN: The five that are named in the
6 motion.

7 THE COURT: Right. It's not those who joined in
8 the motion or anything like that?

9 MR. GOLDMAN: That's correct. That is the
10 definition.

11 THE COURT: All right.

12 [Pause in proceedings.]

13 THE COURT: Defense costs -- as I recall the
14 motion it's interpreted open-endedly; right? It's going
15 forward as well? And my ruling just covered defense costs
16 incurred today?

17 MR. GOLDMAN: Yes, Your Honor.

18 THE COURT: Okay.

19 MR. GOLDMAN: The motion defines it as the
20 contract defines it, Your Honor.

21 MS. GILBRIDE: Your Honor, not to interrupt but
22 does it make sense to include your order on the dismissal
23 motion in this order as well so that for purposes of an appeal
24 that there's one order?

25 THE COURT: No.

1 MS. GILBRIDE: Okay.

2 THE COURT: Okay. Let me tell you what I've
3 written here because I believe this is the nature of my ruling
4 -- and it's Paragraph 3 -- "Effective ten days after entry of
5 this order Axis is directed upon the exhaustion of the
6 Lexington policy to pay defense costs of movants in the
7 underlying actions billed through the date of this order until
8 such time" -- I'm sorry -- "pending a final determination by
9 this Court of Axis' claimed right to withhold such defense cost
10 payments until there's a final determination of its denial of
11 coverage under the Axis policies." Because I'm not going to be
12 making a determination generally of coverage as this order had
13 provided.

14 MR. GOLDMAN: So as I understand it and I believe
15 this is what the Court had discussed, we would have a right to
16 ask the Court to consider further defense costs presumptively
17 on or about October 12th?

18 THE COURT: Yes, because this is just a
19 preliminary injunction. We're going to have the final hearing
20 -- I can't have the final hearing on October 12th.

21 MR. GOLDMAN: Yes. I do not have a problem with
22 that language, Your Honor.

23 THE COURT: All right. So just to be clear and I
24 think this is important for the record, too, I will not be
25 determining all of the issues as to whether your clients are

1 covered for defense costs. What I am determining is whether
2 Axis is required to advance those monies now --

3 MR. GOLDMAN: We understand that, Your Honor.

4 THE COURT: -- as opposed to their argument which
5 is that because of the language on Page 8 that they could say
6 these aren't covered and, therefore, they don't have to be
7 advanced.

8 MR. GOLDMAN: We understand that that is the
9 dispute the Court is considering.

10 MR. EISEN: Your Honor, with the Court's leave, I
11 will be brief. Our bills are also before Axis. As the Court
12 knows, we joined in the motion. We do not -- I've conferred
13 with my colleagues -- all of the indicted defendants -- the
14 presumptively innocent defendants as Your Honor noted -- are in
15 the most -- according to the Court's reasoning in the most --

16 THE COURT: I can't do it. I can't do it on the
17 procedural posture that we're in. I understand logically your
18 client's position but they have not a procedural setting, I
19 believe, to seek a preliminary injunction. They haven't
20 started an adversary proceeding, they haven't made a
21 counterclaim. They are defendants in an adversary proceeding
22 that I've dismissed and they have no counterclaim that survived
23 because they didn't make a counterclaim.

24 MR. EISEN: Your Honor, I understand. I believe
25 it would not be improvident, though, for the Court to issue an

1 order that construes -- because it's the same policy at least
2 as to the --

3 THE COURT: But orders don't do that. I'm sorry,
4 I can't do that. I won't do that. You've heard my ruling.
5 There are aspects of a request for a preliminary injunction
6 that may not apply conceivably to your clients or to other
7 defendants but on the fundamental issues you've heard my ruling
8 as to likelihood of success on the merits or the balance of
9 harms and substantial questions going to the merits and that's
10 as far as you could tell your clients that they could have any
11 sort of comfort at this point.

12 MR. EISEN: Your Honor, whatever the balance of
13 harms may be as to others the assets have been frozen for the
14 defendants.

15 THE COURT: Well, I understand but sometimes, I
16 think -- not sometimes, always, unless the other side is
17 willing to waive it and they're not waiving it and I understand
18 why, you have to go through the procedural hoops.

19 MR. EISEN: Thank you, Your Honor.

20 THE COURT: Okay. I've looked at the rest of the
21 order except for a numbering problem and my inserting after
22 "seeking reimposition of the automatic stay" in the next to the
23 last paragraph "to the extent it applies," I don't have any
24 other changes in it.

25 MR. GOLDMAN: Thank you, Your Honor.

1 THE COURT: Do you have a disc?

2 MR. GOLDMAN: Not with us, Your Honor.

3 THE COURT: Okay. All right. Well, then what I'd
4 ask you to do is to e-mail what you handed me to chambers and
5 I'll mark it up as I read out.

6 MR. GOLDMAN: Okay. We will arrange that this
7 afternoon.

8 THE COURT: Okay.

9 MR. GOLDMAN: Thank you very much.

10 MS. GILBRIDE: Your Honor, will we get the
11 dismissal order this afternoon as well?

12 THE COURT: I don't know. Are you going to submit
13 it to me?

14 MR. WALSH: We'll try, Your Honor.

15 THE COURT: Okay. If not it will be tomorrow. It
16 will get out very promptly.

17 MS. GILBRIDE: Okay. Thank you.

18 MR. EISEN: Your Honor, one very quick -- it's not
19 on that motion. Not at all.

20 THE COURT: A different point? Okay. Good.

21 MR. EISEN: We had a stay motion before the Court.
22 I believe the need for the stay motion has been obviated by
23 the overlap.

24 THE COURT: It's moot. It's moot.

25 You're right I should have addressed that but I

1 believe it's moot.

2 MR. EISEN: Thank you, Your Honor.

3 THE COURT: And in fact you could insert that in
4 the dismissal motion if you want or submit your separate order
5 on that if you wish. You could talk to Mr. Walsh about that.

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I certify that the foregoing is a court transcript from
an electronic sound recording of the proceedings in the above-
entitled matter.

Ruth Ann Hager

Dated: August 31, 2007

EXHIBIT B

Transcript 10 05 07 (Koeltl).txt

1

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1 UNITED STATES DISTRICT COURT
1 SOUTHERN DISTRICT OF NEW YORK

2 -----X

2
3 AXIS REINSURANCE COMPANY,

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4 Plaintiff,

4
5 v.

M-47 (JGK)

5
6 PHILLIP R. BENNETT, LEO R.
6 BREITMAN, NATHAN GANTCHER,
7 TONE GRANT, DAVID V. HARKINS,
7 SCOTT L. JAECKEL, DENNIS A.
8 KLEJNA, THAMAS H. LEE, SANTO
8 C. MAGGIO, JOSEPH MURPHY,
9 RONALD L. O'KELLEY, SCOTT A.
9 SCHOEN, WILLIAM M. SEXTON,
10 GERARD SHERER, PHILIP
10 SILVERMAN, ROBERT C. TROSTEN,
11 AND DOES 1 TO 10,

11
12 Defendants.

12
13 -----X

13 New York, N.Y.
14 October 5, 2007
14 10:25 a.m.

15 Before:

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16 HON. JOHN G. KOELTL,

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18 District Judge
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SOUTHERN DISTRICT REPORTERS, P. C.
(212) 805-0300

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Transcript 10 05 07 (Koeltl).txt
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1 (In open court)
2 THE DEPUTY CLERK: With regard to the matter of Axis
3 Reinsurance, all parties please state who they are for the
4 record.
5 MS. GILBRIDE: Good morning, your Honor. Joan
6 Gilbride, Kaufman, Borgeest & Ryan for Axis Reinsurance
7 Company. With me is Robert Benjamin of the same firm.
8 THE COURT: Good morning.
9 MS. MOSES: Good morning, your Honor. Barbara Moses,
10 Morillo, Abramowitz for Robert Trosten, who is one of the
11 plaintiffs in the Grant adversary.
12 MR. WALSH: Good morning, your Honor. Michael Walsh
13 from Weil, Gotshal & Manges. We represent Leo Breitman, Nathan
14 Gantcher, David Harkins, Scott Jaeckel, Thomas Lee, Ronald
15 O'Kelley, Scott Schoen, often referred to as the Director
16 Defendants.
17 MR. KLINE: Good morning, your Honor. Ivan Kline from
18 Friedman & Wittenstein for William Sexton and Gerard Sherer who
19 are two of the what's been labeled as the counterclaimants
20 among the officers.
21 MS. KIM: Good morning, your Honor. Helen Kim, Baker
22 & Hostetler, counsel for Dennis Klejna, who is a counterclaim
23 plaintiff in the Axis Adversary proceeding.
24 MR. GOLENBOCK: Good morning, your Honor. Jeffrey
25 Golenbock of Golenbock, Eiseman for Phillip Bennett in the
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1 Grant against Axis proceeding.
2 MR. CASHMAN: Good morning, your Honor. Richard
3 Cahman of Heller, Ehrman for Philip Silverman. He's one of the
4 counterclaim plaintiffs.

Transcript 10 05 07 (Koeltl).txt

5 MR. JEROME: Good morning, your Honor. John Jerome
6 for Joseph P. Murphy.

7 MS. NEISH: Good morning, your Honor. Laura Neish,
8 Zuckerman, Spaeder for Tone Grant.

9 THE COURT: Good morning, all. I know lawyers at
10 various of your firms, but nothing about that affects anything
11 that I do in the case, and I don't believe that I know any of
12 you individually, but in any event, nothing about that affects
13 anything I do in the case.

14 This is a motion to withdraw the reference. I've read
15 the papers. I'm prepared to listen to argument.

16 MS. GILBRIDE: Good morning, your Honor. Joan
17 Gilbridge for Axis Reinsurance Company. Your Honor, we're here
18 this morning on a motion to withdraw the reference to
19 bankruptcy court, and our motion is based upon the interest of
20 judicial economy, fairness, and efficiency. At an August 30
21 hearing in the bankruptcy court, the bankruptcy court judge
22 strongly suggested that one of the parties to the adversary
23 proceeding at the time make this motion to withdraw the
24 reference. In fact, he indicated that on the record at least
25 twice. I believe that the bankruptcy --

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1 THE COURT: Let me give you a perspective, having read
2 the papers, and then you can at least speak to that
3 perspective. It appears to me that the bankruptcy court is
4 making a distinction between the underlying coverage dispute
5 and the issue of the advancement of fees. He made that
6 distinction by dismissing your complaint and granting a
7 preliminary injunction for the advancement of fees, and he
8 viewed the advancement of fees as a legal question to be
9 decided as a matter of law. He's teed up the issue, so to
10 speak, for the motions for summary judgment to be heard before
11 him on October 12. There's a new adversary proceeding, but
12 based on everything that the bankruptcy court has said, one
13 would expect that at some time the bankruptcy court will not
14 take jurisdiction over that aspect of the adversary proceeding,
15 which is the coverage issue, and proceed to decide the
16 advancement issue; and if he didn't do that, it's that coverage
17 issue that he considered to be so intertwined with what was at
18 issue before Judge Lynch that he thought he shouldn't decide,
19 one would expect that he would do that with a new adversary
20 proceeding also. If he didn't do that, there could always be a
21 motion to withdraw the reference with respect to that. But the
22 motion to withdraw the reference now comes to me about a week
23 before the bankruptcy judge is going to hear the issue of
24 summary judgment on the advancement of fees.

25 So, I don't read what the bankruptcy court has said

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1 inviting the withdrawal of the reference to be an invitation to
2 withdraw the reference from him on the issue of the advancement
3 fees which he's plainly divided from the issue of coverage.

4 MS. GILBRIDE: Your Honor --

5 THE COURT: That's why I interjected myself when you
6 got to the point that the bankruptcy court has invited the
7 motion to withdraw the reference. The bankruptcy court in fact
8 has said, I am compelled to decide the issue of the motion for
9 summary judgment on the advancement of fees unless the motion

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10 is withdrawn, and the bankruptcy judge knows that there's a
11 motion to withdraw the reference.

12 MS. GILBRIDE: I understand. That's the procedural
13 history of the matter your Honor. Frankly, you know, we
14 disagree with the bankruptcy court's bifurcation of the issues,
15 if you will. That's an issue that is going to come before this
16 court, clearly.

17 THE COURT: Right. And that's an issue with respect
18 to the varying interpretations of the contract as to when it
19 says covered costs, what does that mean?

20 MS. GILBRIDE: Right. Our position is that the
21 question of coverage is the threshold issue that a court has to
22 look at before it gets to this advancement issue, and that's
23 the position we've advocated --

24 THE COURT: But that's not what the bankruptcy court
25 is doing. And if that's wrong, the bankruptcy court will make

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1 that same error when it decides the motion for summary
2 judgment. That error will then be reviewed by this court. If
3 error, it will be reversed.

4 MS. GILBRIDE: Your Honor, I believe it's in the
5 interest of judicial economy that rather than let that error
6 occur, that a withdrawal be granted now so that the issue and
7 all of the issues that -- you know, the issues that are pending
8 before Judge Lynch, the issues that overlap or are duplicated
9 all be decided in one forum; otherwise, there's the possibility
10 of conflicting results --

11 THE COURT: What conflicting results? The only issue
12 that the bankruptcy court has indicated that it's going to be
13 deciding is the issue of contract interpretation, which you all
14 told me last time doesn't require any development of the facts.
15 It does not require any parol evidence. Both sides agree it's
16 a question of pure contract interpretation.

17 MS. GILBRIDE: Your Honor, just so the record is
18 clear, our position is that it is a question of pure contract
19 interpretation, but the insureds are arguing that there's an
20 ambiguity. Our position on that is if there is an ambiguity,
21 the court must look at extrinsic evidence. There's been no
22 opportunity for any discovery in the bankruptcy proceeding.
23 That's the position we've taken in response to the summary
24 judgment motion.

25 THE COURT: OK. You can correct me if I'm wrong, but

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1 I thought that the parties when they appeared before me last
2 time said that the issue -- but I could be mistaken. I thought
3 that your position was that the issues with respect to the
4 interpretation for advancement of costs was an issue strictly
5 of contract interpretation that could and should be determined
6 solely on the basis of the contract.

7 MS. GILBRIDE: Your Honor, I mean, certainly our
8 position of the contract is clear. That's our position. We
9 are not pushing for summary judgment. That's not our motion,
10 but all I'm saying is that if the court, the bankruptcy court,
11 was to perceive an ambiguity, which it appears that's the way
12 he's going, then that would be the basis for the ruling, that
13 our position in opposition to the motion is that you need to
14 look at extrinsic evidence. There's been no extrinsic evidence

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15 introduced, and there's been no time for discovery, and that's
16 going to become an issue. I have no idea whether or not that's
17 argument that would be persuasive, but that's certainly our
18 position, and I don't believe we've taken a inconsistent
19 position in that regard.

20 THE COURT: Is there only one motion for summary
21 judgment pending before the magistrate judge -- before the
22 bankruptcy court?

23 MS. GILBRIDE: There's actually, I think, technically
24 four motions. There are four groups of defendants, and I don't
25 want to misspeak. I'm sure lawyers will tell you if I'm wrong,

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1 but I believe they're essentially the same arguments. There's
2 some slight differences, but they're more or less the same
3 arguments, but there are four pending motions for summary
4 judgment.

5 THE COURT: All by the insureds?

6 MS. GILBRIDE: Yes. Yes. We've also made a
7 cross-motion for summary judgment on a very limited issue with
8 respect to repayment. Our argument there is that if the court
9 is to order advancement of defense costs, that based on the
10 contract if there's a later determination that there is no
11 coverage, that we should be entitled to repayment.

12 THE COURT: I thought there were cross-motions, that's
13 why I -- OK.

14 MS. GILBRIDE: We filed cross-motion. That's the only
15 other cross-motion that there is.

16 In any event, your Honor, we believe that this matter
17 is properly before the district court. I believe that the
18 bankruptcy court made that clear. Perhaps we misread what he
19 was saying. He certainly said that he could bifurcate these
20 issues, and that he felt that he was constrained to rule upon
21 this advancement issue if he kept it because it didn't overlap.
22 Our position is that it overlaps. There's no way that you can
23 read that policy and not conclude that there's an overlap
24 between the word coverage and the advancement of defense costs.
25 So I don't --

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1 THE COURT: You can explain to me -- I'm sure you've
2 explained this to the bankruptcy judge also -- why the ultimate
3 questions of whether there are exclusions in the policy or
4 whether the warranty letter meant that it will eventually be
5 determined that these defense costs are not payable costs under
6 the policy is necessarily the same as the issue of whether the
7 policy gives the insurance company the right at the outset in
8 deciding whether these are covered defense costs to make that
9 determination and refuse to pay.

10 The bankruptcy judge doesn't seem to be under any
11 desire to rule at this point whether any of the exclusions or
12 the warranty letter mean that ultimately the insurance company
13 does not have to pay, but the bankruptcy judge says, I will
14 decide as an initial matter as a question of contract
15 interpretation whether the insurance company must at least
16 advance the costs and cannot simply rely upon alleged
17 exclusions under the policy, which may eventually be found to
18 be a defense for the insurance company to ultimate payment, and
19 may require the insureds to repay defense costs. I will

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20 interpret the policy to determine whether under the policy the
21 insurance company has the obligation to advance the defense
22 costs in the same way that the prior insurers all advanced
23 defense costs. And I'm not going to get into the ultimate
24 merits of the exclusions, but I will simply make the initial
25 question of advancement, and you say, well, your interpretation

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1 of the policy is wrong.

2 I understand that. And if you prevail on that
3 question of contract interpretation, then you'll not be
4 required to advance the costs, but the bankruptcy court will
5 never reach, as I read what he's doing, the ultimate question
6 of whether you are ultimately right on the issue that there are
7 exclusions here that will ultimately be a defense that you'll
8 never have to pay, and to the extent that you've advanced
9 costs, they will have to be repaid.

10 But both sides are arguing out to the bankruptcy judge
11 solely the issue of advancement and whether the interpretation
12 of the policy gives the insurance company the right at the
13 outset to define the covered defense costs to include -- to
14 gives the insurance company the right to say, well, because we
15 believe there is an exclusion, we don't have to advance.

16 MS. GILBRIDE: Your Honor, that's precisely the reason
17 why we think the reference should be withdrawn.

18 THE COURT: Why?

19 MS. GILBRIDE: Because the two issues are interwoven.
20 You can't decide -- I think it's clear under New York law that
21 you can't decide whether there's coverage unless you look at
22 the insuring agreement and the exclusions. So, the bankruptcy
23 court needs to do that, and the bankruptcy court has made it
24 clear that he doesn't think that he can do that because of the
25 overlap with the matters before the district court.

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1 So, I'm not quite sure how we get to this ruling on
2 advancement without acknowledging the fact that there's overlap
3 with the matter that's pending in the district court. Covered
4 defense costs -- to get to interpret the phrase covered defense
5 costs, it's clear under New York law that you have to look at
6 what's covered and what's excluded. And if you start looking
7 at what's excluded, you have to start looking at the facts that
8 the bankruptcy court has already determined are overlapping
9 with what's in the district court.

10 THE COURT: But it's plain, isn't it, that the
11 bankruptcy court is not going to do that. The bankruptcy court
12 is not going to -- and you can correct me if I'm wrong -- I'm
13 just reading the record and seeing what the bankruptcy court is
14 saying at this point. He hasn't yet decided the motions for
15 summary judgment. The bankruptcy court isn't going to rule on
16 the merits on any of the exclusions, in which case he will say
17 that's error, and that will be a matter of law that will then
18 be up on appeal, but he's not going to touch the merits of the
19 exclusions.

20 MS. GILBRIDE: I think you're absolutely right that
21 based on the record that exists, the extent of briefing and the
22 record that exists, that appears to be where the bankruptcy
23 court is going.

24 THE COURT: And then there will be this nice issue of
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25 Law of contract interpretation on the issue of advancement
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1 which will come up on appeal to the district court, and then to
2 the extent that there is anything left in the bankruptcy court,
3 the bankruptcy court has indicated, though not yet ruled, I
4 believe -- you can correct me if I'm wrong -- that whatever
5 remains of the other adversary proceeding, the bankruptcy has
6 no reason to believe that the bankruptcy court would hear that
7 any more than he heard the rest of your case, and then the
8 issue of the exclusions and coverage will all be before
9 eventually Judge Lynch.

10 MS. GILBRIDE: Your Honor, it's our position that the
11 bankruptcy court believes -- it's our position that the
12 bankruptcy court expressed a clear preference to -- what we
13 heard -- that he rather not do that, that he doesn't think
14 that's efficient.

15 THE COURT: Which?

16 MS. GILBRIDE: To have this bifurcation of issue. He
17 obviously said he could do it and he must do it because he had
18 jurisdiction, but the indication throughout the record was that
19 the reference should be withdrawn and that the issues of
20 coverage overlapped clearly with what was before the district
21 court. I think the bankruptcy court felt constrained to keep
22 these counterclaims and perhaps didn't realize they were as
23 broad as they actually are. I think the bankruptcy court
24 thought they were limited just to advancement. They're not.
25 When you look at them, they are as broad as our claims were.

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1 They seek a declaration of coverage.

2 I think you're absolutely right that there is no
3 question that he will only rule upon this advancement issue.
4 He has not dismissed the remainder of the counterclaims or
5 anything extraneous to the advancement issue yet in the
6 bankruptcy court, but I'm sure that he will.

7 THE COURT: And if he doesn't, there would be nothing
8 to prevent a subsequent motion to withdraw the reference if the
9 bankruptcy judge should be going beyond the issue of
10 advancement, right? And under the statute, cases can be
11 withdrawn in whole or in part, so it would be possible to
12 fashion this either by what the bankruptcy court does or a
13 subsequent motion to withdraw the reference to assure that
14 there's no overlap between the action that you've filed now in
15 the district court and what remains in the bankruptcy court.

16 MS. GILBRIDE: Your Honor, obviously, we've been told
17 or the argument is that this motion to withdraw the reference
18 is not timely. I'm sure if there was a subsequent motion,
19 there would be issues about timeliness raised as well.

20 THE COURT: I think I can make it clear that if I
21 thought the present motion was untimely because it comes at a
22 point that suggests that it may have tactical reasons in view
23 of where it comes in the bankruptcy court proceeding, that
24 those considerations will not affect the subsequent decision
25 with respect to a withdrawal of the reference with respect to

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1 whatever remains in the bankruptcy court.
2 MS. GILBRIDE: Your Honor, there are remaining issues
3 in the district court, obviously. There's our complaint that
4 we filed. There is -- inevitably this case, the question of
5 coverage is going to be before a court, and we believe strongly
6 and think the bankruptcy court steers in this direction that it
7 should all be decided by one court, and I think the bankruptcy
8 court thought the appropriate court for that was Judge Lynch
9 since he had the underlying litigation; that there were
10 connections in terms of discovery, settlement, all sorts of
11 issues for practical purposes that he thought this coverage
12 dispute should be before the district court. I think the
13 timely time to do that would be now before there's further
14 rulings by the bankruptcy court that will just involve appeals
15 and countless more motions and judicial resources being
16 utilized when it could all be decided in one place.

17 THE COURT: Are the motions fully briefed before the
18 bankruptcy judge?

19 MS. GILBRIDE: The reply briefs have not been filed
20 yet. The motion was filed. The oppositions were filed, and
21 we're still waiting for reply briefs.

22 THE COURT: When is the reply brief to be filed?

23 MS. GILBRIDE: The 10th. The hearing is on for the
24 12th. So, your Honor, it's our position that in the interest
25 of judicial efficiency, the motion to withdraw the reference

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1 should be granted at this time, and for all the reasons set
2 forth in our papers. Do you have any questions, your Honor?
3 THE COURT: No. Thank you, you've helped me in terms
4 of understanding the case. Thank you.

5 Ms. Moses.

6 MR. WALSH: Thank you, your Honor. I represent
7 Mr. Trosten. I'm also going to speak extremely briefly this
8 morning on behalf of the other Grant plaintiffs, Mr. Grant and
9 Mr. Bennett, and on behalf of the counterclaimants in the Axis
10 adversary who are Messrs. Klejna, Murphy, Sexton, Sherer and
11 Silverman. And if I've forgotten anyone, I'm sure my
12 co-counsels will let me know. Mr. Walsh to my right, I believe
13 wishes to also speak on behalf of the Breitman plaintiffs. I
14 will be very brief, your Honor.

15 I really just want to touch on two points. The first
16 is the bankruptcy court's intent, and the second is the
17 possibility of inconsistent results absent a withdrawal of the
18 reference.

19 With respect to the bankruptcy court's intent, I think
20 your Honor correctly read what Judge Drain had in mind, and I
21 think the most relevant page of the transcript below is page 82
22 of the August 30 transcript where Axis' counsel actually said
23 to Judge Drain, referring to the advancement claims: "You're
24 asking us to go to another courthouse to litigate this." And
25 the court said no. Judge Drain said, "No, I'm asking you to

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1 tell me whether in fact your client is going to pay or not,"
2 and then the court said that it would be happy to determine
3 those issues, the advancement issues in the bankruptcy court.
4 So I think your Honor got it exactly right.

5 With respect to the possibility of inconsistent
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6 results, I think, given where this case is and how the issues
7 have been teed up in the bankruptcy court, there's zero
8 possibility of inconsistent results. And I say that for two
9 reasons. First, as your Honor just pointed out, Judge Drain
10 has made it very clear that the issue he intends to decide a
11 week from today on summary judgment is the narrow contract
12 interpretation issue of whether under the language of the Axis
13 policy and the underlying policy Axis has an interim funding
14 obligation which continues in the face of an unresolved dispute
15 over ultimate issues of coverage and liability.

16 If Judge Drain were to grant summary judgment for the
17 insureds on that issue, obviously that could not possibly
18 conflict or overlap with anything Judge Lynch is doing with
19 regard to the securities fraud class action.

20 Now, Axis, of course, argues the opposite of that
21 question. And if Axis should prevail next Friday on the 12th
22 and if Judge Drain at that point should change his tentative
23 view and should agree that he has to look at the underlying
24 fraud issues, the broader coverage issues, in order to
25 determine the advancement question, he's made it clear that

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1 he's not going to do that. He actually said on page 58 of the
2 September 11 transcript, that if he were to come out that way,
3 then there would be an overlap, and at that point this
4 adversary proceeding, referring to the Grant proceeding, and
5 the adversary proceeding brought by the counterclaim parties
6 would be either stayed or dismissed without prejudice pending
7 the development of those facts in the multi securities district
8 litigation.

9 So either way he goes, your Honor, there's zero danger
10 that Judge Drain is going to make rulings on those coverage
11 issues, those fraud-related issues, which would pose a danger
12 with being inconsistent with anything Judge Lynch or Judge
13 Buchwald has done or is going to do in the district court with
14 respect to those overlapping fraud issues.

15 So I would submit, your Honor, that looking at the
16 ultimate questions which are efficiency and uniformity, that
17 this case actually comes to you in a posture very similar to
18 two prior withdrawal cases that your Honor decided and that are
19 cited to you in the papers In Re Ames and In Re Formica, and
20 that the most efficient thing to do is clearly to let Judge
21 Drain decide the summary judgment motions that he's got teed up
22 and ready to go a week from today. Thank you.

23 THE COURT: OK.

24 MR. WALSH: Your Honor, Michael Walsh on behalf of the
25 Director Defendants. I think just about everything has been

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1 covered. I just want to make two very quick points. Axis'
2 counsel stated that if there is an issue of ambiguity on the
3 contract, the court would have to look at evidence that's
4 outside the contract. I think obviously that will be argued
5 better in front of the bankruptcy court but argued would be
6 that ambiguity as a matter of law would be held against the
7 insurer and in favor of the insureds, so even if there is
8 ambiguity, I don't think we would go beyond the contract.

9 Second, Axis, I think, may have implied that all of
10 the directors and officers have these counterclaims that the

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11 court has not disposed of. Certainly, the Director Defendants
12 are seeking advancement only and are not seeking a
13 determination in the bankruptcy court of the larger issue of
14 liability of Axis under the policy.

15 THE COURT: What's your position with respect to the
16 proceedings before the bankruptcy court and whether they're
17 core or non-core?

18 MR. KLINE: I think that a strict interpretation of
19 the contract is not a core proceeding, and I don't think we
20 were as clear in our papers on that issue as I wish we were,
21 but I think the point we were making is that in looking at the
22 core/non-core issue as a factor in withdrawal, the reason to
23 look at that is for two reasons: One is the issue of the scope
24 of review, and the other is the issue of the expertise of the
25 bankruptcy court.

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1 On the scope of review, clearly we're saying that this
2 is a question of law. So that's review de novo and that does
3 not help our argument. But in terms of the expertise of the
4 bankruptcy court and the understanding of what this dispute
5 means to the rest of the bankruptcy court does fall within the
6 bankruptcy court's expertise and is a factor -- although we
7 don't think determinative -- it is a factor that this court
8 could take into account in making the decision.

9 THE COURT: Thank you for your frankness. The papers
10 that various insureds submitted were not consistent that the
11 proceedings as to which withdrawal is sought are in fact
12 non-core proceedings. In fact, they tried to say that the
13 bankruptcy judge has found that they are core proceedings, and
14 it's not clear to me that the bankruptcy court has made such a
15 finding.

16 MR. KLINE: That may have been our papers, your Honor.
17 I think all we are trying to say is that the bankruptcy court
18 referred to provisions of the plan or relief from the stay as
19 being core, and that those issues were implicated by his
20 decision, but the contract interpretation itself we did not
21 mean to imply was core at all.

22 THE COURT: OK. Anyone else? No. I'm prepared to
23 decide.

24 The defendant, Axis Reinsurance Company ("Axis") has
25 filed a motion to withdraw the reference from the United States

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1 Bankruptcy Court for the Southern District of New York ("the
2 Bankruptcy Court") in the consolidated adversary proceedings.
3 Axis argues that the adversary proceedings are non-core
4 proceedings, and therefore the reference should be withdrawn in
5 the interest of judicial economy, particularly in light of the
6 fact that certain of the insureds have demanded a jury trial.

7 In relevant part, 28 U.S.C. Section 157(d) provides:
8 "The district court may withdraw, in whole or in part, any case
9 or proceeding referred under this section, on its own motion or
10 on timely motion of any party, for cause shown." While the
11 statute does not define the phrase "for cause," courts have
12 focused on whether the proceeding is core or non-core as well
13 as considerations of judicial economy and uniformity in the
14 administration of bankruptcy law. See, for example, Orion
15 Pictures Corporation v. Showtime Networks, Inc. (In re Orion

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16 Pictures Corp.), 4 F.3d, 1101, (2d Cir. 1993); Hunnicutt Co. v.
 17 TJX Cos. (In re Ames Department Stores, Inc.), 190 B.R. 157,
 18 162, (S.D.N.Y. 1995).
 19 "There is no specific time limit for applications
 20 under 28 U.S.C. Section 157 to withdraw a reference to the
 21 bankruptcy court..." Lone Star Industries, Inc. v. Rankin
 22 County Economic Development District. (In re New York Trap
 23 Rock Corp.), 158 B.R. 574, 577, (S.D.N.Y. 1993). In situations
 24 where timeliness is not governed by a specific timetable, the
 25 court must assess timeliness in the context of the parties'
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1 interactions throughout the course of the litigation in the
 2 bankruptcy court. Id. Therefore, "courts in this Circuit have
 3 defined 'timely' to mean 'as soon as possible after the moving
 4 party has notice of the grounds for withdrawing the
 5 reference.'" Official Committee of Unsecured Creditors of FMI
 6 Forwarding Co., Inc. v. Union Transport Corp. (In re FMI
 7 Forwarding Co., Inc.), No. 04 Civ. 630, 2005 WL 147298, at *6
 8 (S.D.N.Y. Jan. 24, 2005 (quoting Kentile Floors, Inc. v.
 9 Congoleum Corp. (In re Kentile Floors, Inc.) No. 95 Civ. ,
 10 2470, 1995 WL 479512, at *2. (S.D.N.Y Aug. 10, 1995)).
 11 Based on the particular circumstances at issue, a
 12 delay that is acceptable in one case may not be acceptable in
 13 another case. Id.; compare Connolly v. Bidermann Industries
 14 U.S.A., Inc., No. 95 Civ. 1791, 1996 WL 325575, at *3 (S.D.N.Y
 15 June 13, 1996 (finding timely a motion to withdraw reference
 16 filed after a delay of eight months), with In re Kentile
 17 Floors, Inc., at *2 (finding timely a motion to withdraw
 18 reference filed after a delay of nine months, where the parties
 19 had been in mediation for several months and the motion was
 20 filed promptly after mediation was abandoned). It is clear,
 21 however, that "[d]elay for tactical reason, such as forum
 22 shopping, or which prejudices the opposing party or the
 23 administration of justice, can be grounds for denying" a motion
 24 for withdrawal. In re FMI Forwarding Co., at *6; see also In
 25 re New York Trap Rock Corp. 158 B.R. at 577.

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1 In this case, the motion is not timely. Axis had
 2 notice of the grounds for withdrawal at the time it filed its
 3 declaratory action in bankruptcy court in May but instead chose
 4 to invoke the bankruptcy court's jurisdiction pursuant to 28
 5 U.S.C. Section 157(c). The motion to withdraw the reference
 6 was filed more than three months after Axis filed its complaint
 7 in the bankruptcy court. In the interim, the parties expended
 8 resources litigating in that forum, and the bankruptcy court
 9 dismissed Axis's complaint, entered preliminary injunctions,
 10 and scheduled a hearing on October 12, 2007 to decide
 11 cross-motions for summary judgment.

12 Axis argues that the motion is timely because it filed
 13 its motion only one week after the bankruptcy court dismissed
 14 its complaint. However, this argument ignores the fact that
 15 Axis waited for more than three months to file its motion and
 16 only sought removal to this court after the adverse decision in
 17 the bankruptcy court on the motion for a preliminary injunction
 18 and on the motion to dismiss. Up to that point, Axis was
 19 willing to allow the bankruptcy court to adjudicate all the
 20 issues in its complaint, including the advancement issue, and

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21 the bankruptcy court expended considerable time and energy in
22 becoming familiar with the facts and legal issues involved,
23 particularly on the advancement issue. The motion for
24 withdrawal of the reference is made shortly before the
25 bankruptcy court is scheduled to hear oral argument on the

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1 cross-motions for summary judgment on the advancement issue and
2 appears to be a tactical effort to avoid the bankruptcy court's
3 decision on that issue, which will be fully reviewable on an
4 appeal to this court. On the basis of timeliness alone, the
5 motion for withdrawal of the reference should be denied.

6 Even if the motion was timely, Axis has failed to show
7 sufficient cause to warrant withdrawal at this time. Under the
8 framework established by the Court of Appeals for the Second
9 Circuit, the threshold question with respect to "cause shown"
10 is whether the case involves a core or non-core proceeding,
11 "since it is on this issue that questions of efficiency and
12 uniformity will turn." *In re Orion Pictures Corp.* 4 F.3d at
13 1101. After the district court "makes the core/non-core
14 determination, it should weigh questions of efficient use of
15 judicial resources, delay and cost to the parties, uniformity
16 of bankruptcy administration, the prevention of forum shopping
17 and other related factors," such as the presence of a jury
18 demand. *Id.*; see also *Kenai Corp. v. National Union Fire*
19 *Insurance Co. (In re Kenai Corp.)*, 136 B.R. 59, 61, (S.D.N.Y.
20 1992).

21 To be a core proceeding, the proceeding must "arise
22 under" Title 11 or "arise in" a bankruptcy case under Title 11.
23 See *Mt. McKinley Insurance Co. v. Corning Inc.*, 399 F.3d 436,
24 447-48 (2d Cir. 2005). With respect to claims arising from
25 contracts, the important factors are whether the contract is

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1 antecedent to the reorganization petition and the degree to
2 which the proceeding is independent of the reorganization.
3 *United States Lines, Inc. v. American Steamship Owners Mutual*
4 *Protection and Indemnity Association, Inc.*, 197, F.3d, 631, 637
5 (2d Cir. 1999).

6 The insureds now concede that the adversary
7 proceedings here are non-core proceedings. The causes of
8 action do not arise under the Bankruptcy Code and would exist
9 in the absence of a bankruptcy case. The proceedings involve
10 the interpretation of a pre-petition and insurance contract as
11 it relates to non-debtors and therefore are sufficiently
12 removed from the reorganization to be considered non-core.

13 In general, the fact that the proceeding is a non-core
14 proceeding, weighs in favor of withdrawal because in non-core
15 proceedings decisions by the bankruptcy court are subject to
16 de novo review in the district court. *In re Orion Pictures*
17 *Corp.*, 4 F.3d at 1101. The fact that a proceeding is non-core,
18 however, is not determinative because "[i]n the final analysis,
19 the critical question is efficiency and uniformity." *In re FMI*
20 *Forwarding Co.* at *5.

21 Therefore, the argument for withdrawal based on the
22 non-core nature of the proceedings is significantly lessened in
23 situations where the bankruptcy court has already expended
24 significant resources on the case and where other factors weigh
25 strongly against withdrawal. It would be an inefficient use of

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1 judicial resources to withdraw this proceeding from the
2 bankruptcy court at this time and lose the advantage of the
3 bankruptcy court's views on the dispute relating to the
4 advancement of fees.
5 Axis only sought to remove the reference after the
6 bankruptcy court dismissed its complaint and granted
7 preliminary injunctions requiring it to advance defense costs.
8 Facing a potential permanent injunction requiring the advancement
9 of fees by the bankruptcy court, Axis now moves to withdraw the
10 reference. In situations where the timing and circumstances of
11 a motion to withdraw the reference raise a strong inference of
12 forum shopping, the motion should be denied. See, for example,
13 In re New York Trap Rock Corp. 158 B.R. at 577 (noting that
14 withdrawing the reference 11 days after adverse findings by the
15 bankruptcy court "would reward forum shopping"); In re Kenai
16 Corp. 136 B.R. at 61.
17 Axis' argument that its motion is made at the
18 suggestion of the bankruptcy court and is therefore timely and
19 not motivated by forum shopping is unpersuasive. First, the
20 bankruptcy court appears to have been referring to the ultimate
21 issue of coverage, rather than the discrete issue of
22 advancement of expenses, when it suggested that it saw the
23 potential for overlapping issues between Axis' complaint and
24 the securities class action currently before Judge Lynch.
25 (Transcript 57-59, dated August 30, 2007, attached as Exhibit 5
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1 to the declaration of Greg A. Danilow.) In any event, Axis'
2 proffered explanation does not change the fact that it could
3 have filed a motion to withdraw the reference at a much earlier
4 date and only chose to file its motion after the bankruptcy
5 court had dismissed its complaint and entered the preliminary
6 injunctions.
7 Additionally, judicial economy is not served by
8 withdrawing the reference at this point. The bankruptcy court
9 has spent considerable time and energy to become familiar with
10 the parties' arguments with respect to the discrete issue of
11 Axis' obligation to advance costs under the policy. Moreover,
12 the bankruptcy court has scheduled a hearing in one week to
13 consider the motions for summary judgment on the advancement
14 issue. Even in light of the fact that the decision of the
15 bankruptcy court will be subject to de novo review on appeal,
16 it would be an inefficient use of judicial resources for the
17 Court to withdraw the reference after the bankruptcy court has
18 become familiar with the case and before it issues its ruling
19 on the dispute relating to advancement. See, for example, In
20 re Ames Department Stores, Inc. 190 B.R. at 163-64.
21 Axis argues that the Court should withdraw the
22 reference because some of the insureds have requested a jury
23 trial. However, the bankruptcy court has decided at this point
24 that the ultimate issue of coverage under the policy is
25 separate and distinct from the issue remaining before the
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1 bankruptcy court; namely, whether the terms of the policy
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2 require Axis to advance defense costs. If the bankruptcy court
3 continues to follow its previous views, that would be an
4 additional issue to be decided on appeal. Therefore, the fact
5 that a jury demand has been made by certain of the insureds on
6 the ultimate issue of coverage does not weigh strongly in favor
7 of withdrawal of the reference where the issue in front of the
8 bankruptcy court, as the bankruptcy court has previously said,
9 is a discrete issue of law which will be decided on
10 cross-motions for summary judgment. Of course, all of the
11 issues involved in that Bankruptcy Court decision on the
12 motions for summary judgment will be fully reviewable de novo
13 on appeal. Furthermore, a jury demand is only one factor in
14 the analysis, and, in any event, the possibility of a jury
15 trial at some later date does not require the court to withdraw
16 the reference in situations where judicial economy would be
17 better served by current proceedings remaining in the
18 bankruptcy court. See, for example, In re Orion Pictures Corp.
19 4 F.3d at 1101-02; In re Ames Department Stores, Inc. 190 B.R.
20 at 162-63; In re Kenai Corp. 136 B.R. at 61.

21 Indeed, as the Court pointed out in oral argument,
22 under the statute, the Court has the authority to withdraw "in
23 whole or in part" any case or proceeding referred to the
24 bankruptcy court. The bankruptcy court by its dismissal of
25 Axis' complaint has made it clear thus far it believes the

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1 underlying coverage dispute should be litigated in the district
2 court. If any part of the coverage dispute were to remain in
3 the bankruptcy court, that may well be the subject of a motion
4 to withdraw the reference for that part of the proceeding at
5 some point in the future.

6 Therefore, Axis' motion to withdraw the reference is
7 denied without prejudice to refile after the bankruptcy court
8 has entered a judgment on the pending motions for summary
9 judgment. So ordered.

10 Let me raise another issue with you very quickly:
11 This case is filed under M-47, and filings under miscellaneous
12 numbers in the clerk's office always produces some issues with
13 respect to filing, etc. Are there any outstanding motions or
14 orders before me that require a decision that remain unopened
15 not correctly filed in the file? Anything else for this court
16 to decide? Anything open?

17 MS. GILBRIDE: Your Honor, there's just the appeal
18 that was stayed. I filed an appeal that we requested be
19 stayed, but other than that, there's nothing else that I'm
20 aware of.

21 THE COURT: Because I know that there were motions to
22 consolidate the cases before me, and I just want to make sure
23 that you've gotten all of the orders that you need and they're
24 all properly filed. From time to time there are pro hac vice
25 motions that are filed but don't get filed in the correct file

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1 but nothing's open except the appeal that's been stayed. OK.
2 Great. Anything else?

3 MS. GILBRIDE: We don't have anything else. Thank
4 you, your Honor.

5 THE COURT: Good morning all. Good to see you all.
6 (Adjourned)

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